The Economist

April 16th, 2011



Politics this week



Barack Obama called for a reduction of $4 trillion over 12 years in the **budget deficit**, to be paid for by a mixture of spending cuts and tax rises on the rich. Although Mr Obama only unveiled his budget in February, he has been forced to lay out new proposals in response to an alternative document put forward by Paul Ryan, the Republican chairman of the House Budget Committee, that calls for a radical overhaul of Medicare and Medicaid, among other things. Mr Obama said that his blueprint offered a more "balanced" approach to reducing the deficit.

With just minutes remaining to a deadline that would have shut down the **federal government**, Republicans in Congress reached an agreement with the White House to fund services in return for more extensive spending cuts. See article

Many Democrats reacted furiously to the deal to avoid a shutdown. Vincent Gray, the mayor of **Washington, DC**, was arrested along with 40 other people at a protest. Republicans included a measure in the deal that bans the city from using local revenues to fund abortions. See article

While the theatrics over the deficit played out in Washington, **Mitt Romney** quietly entered stage right to declare officially his intention to run for president by setting up an exploratory committee. He is the Republican Party's putative front-runner; he announced his entry to the race from New Hampshire, which holds the first primary in 2012. See article

Presidential prerogative

In **Cote d'Ivoire** Laurent Gbagbo was detained by troops loyal to Alassane Ouattara. Mr Gbagbo lost to Mr Ouattara in a presidential election last year but had refused to leave office, plunging the country into strife. Mr Ouattara's troops were backed by France, the former colonial power, and the UN. See article

The British and French governments criticised NATO for failing to destroy enough heavy weaponry used by Muammar Qaddafi's forces in **Libya** to allow rebels to break an ongoing stalemate. See article

Demonstrations escalated in **Syria** as the government cracked down hard, arresting 100 people in a single day. See article

Hosni Mubarak, the former **Egyptian** president, was detained for up to 15 days for questioning about charges of corruption and abuse of office. See article

One man's terrorist...

A jury in Texas acquitted Luis Posada Carriles, an alleged anti-communist terrorist, of perjury and obstruction of justice. **Cuba** and **Venezuela** condemned the verdict and accused the United States of sheltering him. See article

Uruguay's Senate voted to annul a law that had given military officers immunity from prosecution for crimes committed during the country's 1973-85 military dictatorship (it must be approved by the lower house of Congress to take effect). The immunity law was upheld in two referendums, in 1989 and 2009.

Daniel Ortega, **Nicaragua's** president, issued a decree moving three municipalities with large numbers of opposition voters from one electoral department to another. The unconstitutional gerrymandering should help Mr Ortega's party win more seats in an election this November.

Ollanta Humala and Keiko Fujimori, two populist candidates, finished first and second in the first round of **Peru's** presidential election. A run-off will be held in June. See article

A **Guatemalan** court granted a divorce to the country's president and first lady, Alvaro Colom and Sandra Torres. The divorce will enable Ms Torres, who has already declared her candidacy for president, to circumvent a constitutional ban on close relatives of the incumbent from running to succeed him.

Disaster scenarios



Japan raised the severity level at the Fukushima nuclear-power plant to seven, the highest on the accepted international scale. Only the Chernobyl accident 25 years ago ranked as high. The government said the new assessment reflected the accumulated radiation that has escaped the plant, not a sudden deterioration. Total radiation emissions have been a tenth of Chernobyl's so far, with no radiation-linked deaths.

Following **Myanmar's** first parliamentary elections in 20 years and the release from house arrest of Aung San Suu Kyi late last year, the European Union eased long-held travel and financial restrictions on four ministers in the repressive regime.

The government in **Sri Lanka** rejected out of hand a UN report on human-rights violations in the bloody ending of the long civil war in 2008-09. The army's crushing of the rebels at the time also killed, injured or displaced tens of thousands of Tamil civilians. See article

The Pentagon said it would investigate what apparently is the first case of American fatalities from missiles fired by a **drone** in Afghanistan. Two men were killed in the incident.

Mayhem in Minsk

A bomb exploded on the metro in Minsk, the capital of **Belarus**, killing 12 people and injuring more than 200. Two men were arrested on suspicion of planting the device. President Alyaksandr Lukashenka later said they had "confessed". See article

Italy's lower house passed a bill that would in effect end a bribery case against Silvio Berlusconi. Separately, Mr Berlusconi said he planned to step down as prime minister in 2013.

For the second time, **Icelanders** voted against a deal to reimburse the British and Dutch governments for euro4 billion ($5.8 billion) in the bankruptcy of Landsbanki. When the bank's online arm collapsed in 2008, savers in Britain and the Netherlands had their deposits guaranteed by their governments. See article

Poland marked the first anniversary of the plane crash in western Russia that killed its president and 95 others. The late president's brother, who is also leader of the opposition, boycotted the official commemoration, accusing the government of not standing up to Russian claims that the crash was solely the fault of the Polish crew. See article



A ban on wearing the Islamic face-covering veil in public came into force in **France**. There were several arrests following protests, and one woman was fined euro150 for sporting the garment. See article

Index | The world this week

Business this week

An independent commission looking at reforms to **Britain's banking industry** produced its interim report. The Vickers commission recommended that systemically important banks should set aside 10% of capital as a buffer against hard times and ring-fence their retail operations. It also proposed that Lloyds Banking Group, Britain's biggest retail bank, should dispose of more branches. The outlines were generally welcomed, though critics grumbled that the commission had retreated from advocating a more drastic shake-up of the industry. See article

How it all happened

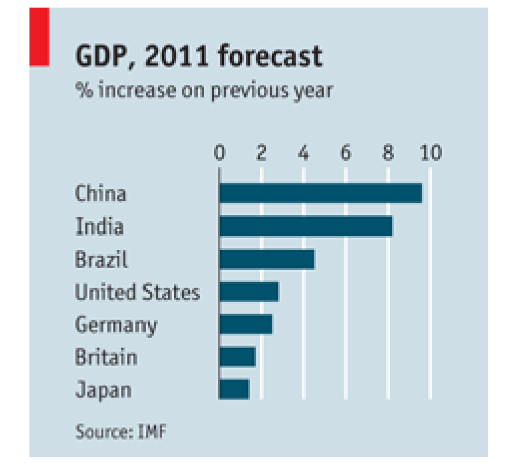
A Senate committee produced an investigative report, assembling thousands of e-mails and other correspondence, into events and practices on **Wall Street** leading up to the banking collapse of 2008. It reserved some of its heaviest criticism for Goldman Sachs. The committee had bipartisan support, unlike the Financial Crisis Inquiry Commission, which reported in January.

Federal bank regulators issued a cease-and-desist order against America's largest **mortgage providers**, including Bank of America and JPMorgan Chase, requiring them to overhaul their foreclosure practices and intensify efforts to mitigate losses for borrowers. Talks over a separate settlement between the banks, state attorneys-general and the Justice Department remain bogged down.

NYSE Euronext said it would stick with a merger bid proposed by **Deutsche Borse**, rejecting a rival, and higher, offer made jointly by **NASDAQ OMX** and **IntercontinentalExchange**. The owner of the New York Stock Exchange insists that a tie-up with the German bourse would be of greater benefit.

Jean-Claude Trichet defended the decision of the European Central Bank to raise **interest rates** for the first time in three years. The ECB lifted its main rate from 1% to 1.25% on April 7th to tackle inflation in the euro zone.

Inflation in Britain unexpectedly fell in March, to 4%, as retailers slashed prices to entice reluctant consumers. The news will affect the Bank of England's thinking on whether and when to raise interest rates this year.



The IMF released its twice-yearly projection of **world economic growth**, forecasting that global **GDP** will increase by 4.4 this year. The fund said that concerns were fading over a "double-dip" recession, though the recovery could be threatened by higher commodity prices, especially oil. Regarding **Japan**, the IMF recognised that the "immediate fiscal priority is to support reconstruction" after last month's earthquake, but urged the country to link such spending to a clear strategy for reducing public debt.

Glencore's announcement that it plans to list up to 20% of its shares in an initial public offering excited the markets. For months investors have been waiting for the world's biggest commodities-trading company to confirm rumours that it would float on the stockmarket. Swiss-based Glencore's IPO is expected to raise up to $11 billion. See article

Paying for wrong decisions

Renault's chief operating officer stepped down over a scandal surrounding wrongful accusations of corporate espionage. The carmaker's head legal counsel, boss of human resources, general secretary and security chief also resigned. In January Renault sacked three executives for allegedly selling company secrets, but it soon emerged that it had been duped by fraudsters. The government made clear it expected heads to roll. Carlos Ghosn, Renault's chief executive, managed to hold on to his.

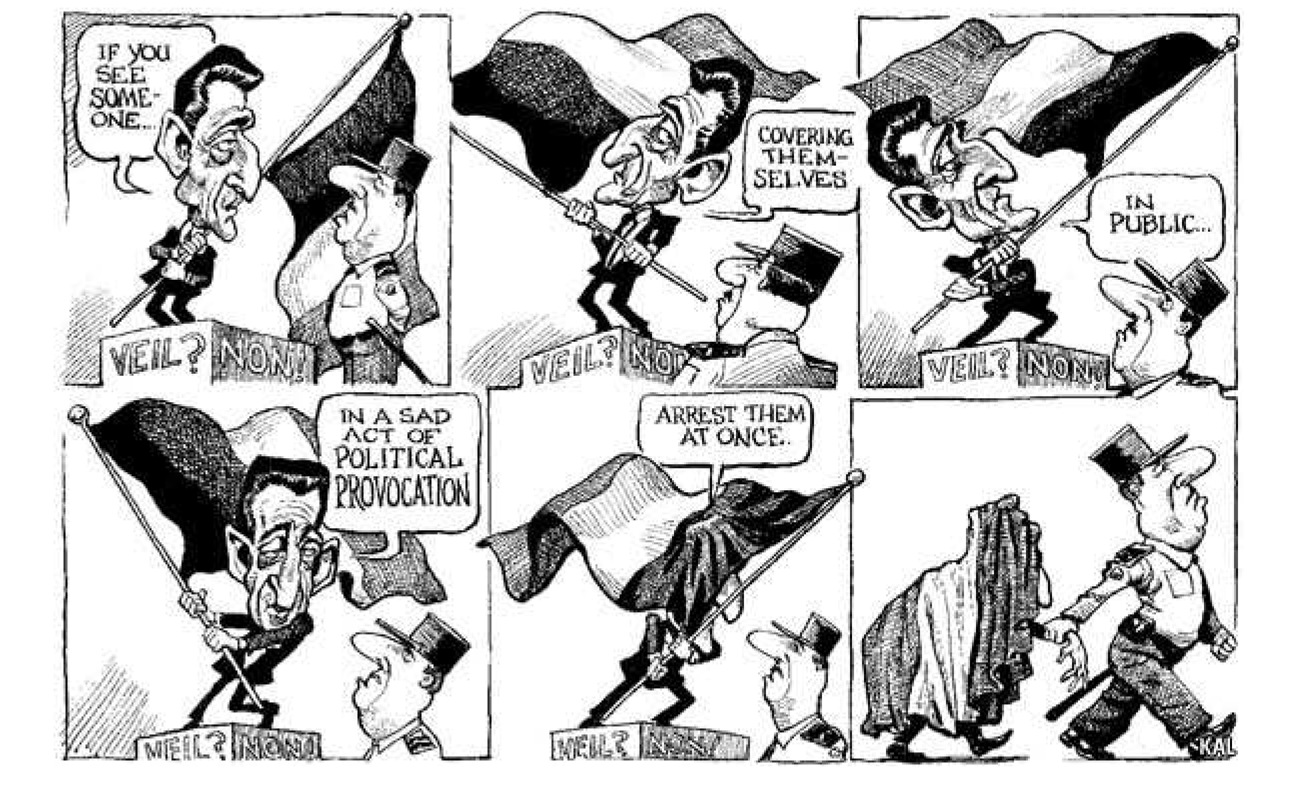
In Detroit a Chinese engineer who worked for **Ford** was sentenced to six years in prison for copying sensitive company documents on engine systems before he left to join a Chinese carmaker.

Mark Zuckerberg, **Facebook's** boss, had a mixed week. An appeals court threw out a claim by the Winklevoss twins that they were misled over the true value of Facebook in a settlement that noted their input as Harvard students into creating the social-networking site (as portrayed in the film "The Social Network"). But after their case was dismissed, new evidence was submitted in a separate dispute over the ownership of Facebook- Paul Ceglia, another former acquaintance of Mr Zuckerberg, says a development deal between the pair entitles him to a large chunk of the company. See article

Flip flops

Cisco decided to stop making the popular **Flip video camera** as part of its strategy to rein in its troubled consumer-products division and refocus on its core businesses. Cisco bought Flip in 2009 for $590m. The small device spurred many copycat gadgets, but smartphones now incorporate better video technology.

Index | The world this week



Index | Leaders

Central America's woes

The drug war hits Central America

Organised crime is moving south from Mexico into a bunch of small countries far too weak to deal with it



FOR most of the 20th century, the small countries of Central America were a backwater, a tropical playground for dictators and adventurers. In the 1970s and 1980s they turned briefly into a violent cockpit of the cold war as Marxist-inspired guerrillas battled US-backed tyrants. Places like El Salvador and Nicaragua generated daily headlines around the

world and bitter partisan battles in Washington. When the cold war ended, peace and democracy prevailed and Central America slipped back into oblivion. But its underlying problems-which include poverty, torpid economies, weak states, youth gangs, corruption and natural disasters-never went away.

Now violence is escalating once more in Central America, for a new reason. Two decades ago the United States Coast Guard shut down the Caribbean cocaine route, so the trade shifted to Mexico. Mexico has started to fight back; and its continuing offensive against the drugs mafias has pushed them down into Central America.

Whatever the weaknesses of the Mexican state, it is a Leviathan compared with the likes of Guatemala or Honduras. Large areas of Guatemala-including some of its prisons-are out of the government's control; and, despite the efforts of its president, the government is infiltrated by the mafia. The countries of Central America's northern triangle (Guatemala, Honduras and El Salvador) are now among the most violent places on earth, deadlier even than most conventional war zones (see article). So weak are their judicial systems that in Guatemala, for example, only one murder in 20 is punished.

A collapse in social order, however bloody, is normally an internal matter. Yet it would be wrong to leave Central America to its own unhappy devices. Although the new violence thrives on the weakness of the state in those countries, its origins lie elsewhere. Demand for cocaine in the United States (which, unlike that in Europe, is fed through Central America), combined with the ultimately futile war on drugs, has led to the upsurge in violence. It is American consumers who are financing the drug gangs and, to a large extent, American gun merchants who are arming them. So failing American policies help beget failed states in the neighbourhood.

Reason to worry

The United States is involved in Central America's troubles not just because it helped cause them, but also because it will feel their consequences. By air, Central America is less than three hours from Miami. It is the gringo "near abroad", a destination for elderly Americans looking for a warm place to retire, though violence will stem the flow. Already the lethal combination of conflict and lack of opportunity is driving thousands of Central Americans to brave the threat of kidnap and extortion to migrate to the United States. More will follow if conditions worsen.

A generation ago, the United States rightly concluded that it had much to gain if the Americas became a community of prospering democracies. Yet it is in Central America that democracy is under greatest threat. The isthmus seethes with ideological polarisation and political mistrust. China is active there. Venezuela's Hugo Chavez is stirring things up. In Nicaragua Daniel Ortega is set to win an illegal third term in an election this year, in part thanks to Mr Chavez's largesse. Honduras saw a coup that ousted an elected, albeit irresponsible, president in 2009. Some Central American countries are doing better: Costa Rica is still one of the safest places in the Americas, for example. But its economic success is based on attracting foreigners as tourists, investors or retired residents. A deteriorating security situation will jeopardise its prosperity-and undermine democracy throughout the region.

Escaping the Hobbesian trap

Central American governments have begun to recognise the scale of the battle they face. But stopping their slide into violent chaos requires many things: reform of the police, prisons and courts; better intelligence and information-sharing; a huge effort to provide more legal opportunities for young men, not least by educating them properly; and more hardware, such as helicopters and patrol boats.



All this, of course, will have to be paid for. Central American governments do not collect enough tax revenue to provide the rudiments of a modern state: security, education and health for their people, and transport infrastructure to allow their economies to reap the full benefit of their privileged position close to the United States. Central America has fallen into a Hobbesian trap: the better-off make private arrangements-there are five times as many private security guards as policemen or soldiers in Guatemala, and four times as many in Honduras-and therefore block efforts to levy the tax revenues necessary to strengthen the state. There is a lesson for Central America's governments in Colombia: the tide turned against *los violentos* only when Alvaro Uribe introduced a wealth tax to pay for a security build-up.

But the Central American governments are not solely responsible for the countries' problems. The drugs policies of the United States are also to blame. And, to cap it all, climate change-to which the unfortunate Central Americans have contributed virtually nothing-seems to be increasing the ferocity of nature in the isthmus. Catastrophic flooding is killing people with increasing frequency, and raising the cost of maintaining infrastructure.

When the guerrilla wars of the 1970s and 1980s ended, Americans forgot about Central America. It is time they remembered it again, and offered some help. They could, for example, lead an aid programme that would tie money for roads, ports and security hardware to increases in the tax take to pay for better security and social conditions.

Such schemes will not, however, solve the fundamental problem: that as long as drugs that people want to consume are prohibited, and therefore provided by criminals, driving the trade out of one bloodstained area will only push it into some other godforsaken place. But unless and until drugs are legalised, that is the best Central America can hope to do.

Index | Leaders

China's repressive new rulers

China's crackdown

The vindictiveness of China's rulers betrays their nervousness



LIKE so much else under Heaven, repression in China has often seemed to go in cycles. Every now and then it has suited the country's leaders to relax their steely grip on the country and allow a modicum of political liberty.

Freer criticism in the media has helped give the party a veneer of credibility. Lip-service to the law and due process has won plaudits overseas and boosted the economy at home. So a thaw would set in for a while, a "Beijing spring". A freeze would always follow. But, until lately, in each new cycle the springs were seeming warmer and the freezes not quite so harsh. When the country was starting to liberalise, Westerners justified doing business with China on just such grounds. More economic openness would surely lead to more openness of other kinds.

The latest freeze casts this widespread hope into doubt, for three reasons. The first is the scale of the crackdown. Ai Weiwei, China's best-known artist and dissident, who was detained at Beijing airport on April 3rd, is only the most notable figure to be caught by it. Calls on the internet for a "jasmine revolution" have prompted armed police and plain-clothes goons to descend in huge numbers on public places to stop people from "strolling", as a veiled form of protest.

Baby, it's cold outside

Dozens have been detained and now face criminal charges in relation to these inchoate calls. Others have faced different kinds of harassment, including beatings and house arrest. But the freeze runs deeper. Since February some of the country's top defence lawyers have vanished. Activists for villagers' rights and the environment have faced repression. Bloggers have been rounded up. Members of a big underground (ie, non-state) church in Beijing, stopped from meeting in their usual building, were arrested as they tried to worship outside.

A second reason for doubt is the duration of the crackdown. With hindsight, it began after Tibetan riots in 2008 drew a harsh response. Since then, two events, the Beijing Olympics later that year and the Shanghai World Expo of 2010, might have served as coming-out parties for a rising China. They offered the regime the chance to show the world a more confident face. Yet both were accompanied by harsh treatment of anyone deemed likely to embarrass the government. Tens of thousands of unwashed migrant workers were forced out of Beijing for lowering the tone. Outspoken activists were kept out of sight.

Even natural disasters have triggered repression. Mr Ai's first serious run-in with the authorities came when he attempted to account for all the schoolchildren killed during the Sichuan earthquake in 2008, many as a result of corrupt building practices. Taking in all its manifestations, which include tightened internet censorship and a stifling of public debate, the latest crackdown on political dissent certainly constitutes the worst since Tiananmen Square in 1989 and its aftermath.

A third reason to doubt the notion of gradual warming lies in the method of repression. Even the post-Tiananmen crackdown had a semblance of due process. Now such pretence is out of the window. People are picked up under arbitrary detention rules and then made to disappear. Mr Ai has not been heard of since being bundled away. Violence is part of the mix. Mr Ai needed brain surgery in 2009 after being beaten up by goons. Foreign journalists are being harassed on a scale unseen since Tiananmen Square. Vaguely defined "state security" is used as a reason to round people up. For perceived "troublemakers" such as Mr Ai, the government says, "no law can protect them."

Western observers tend to describe the crackdown as a massive overreaction to perceived threats, but it may well be that China's rulers know better. True, no seething mass stands ready to overthrow the regime. But in a vast country, many aggrieved people, from dispossessed villagers through unemployed graduates to angry bloggers, resent the state. The government is quite capable of handling each of these groups separately. But were those with grievances ever to coalesce, especially if the growth slows-as it will sooner rather than later (see article)-they would represent a potent force.

The view from Beijing, thus, is different to the view from abroad. Whereas the outside world regards China's rulers as all-powerful, the rulers themselves detect threats at every turn. The roots of this repression lie not in the leaders' overweening confidence but in their nervousness. Their response to threats is to threaten others.

Imminent political change may also play a part. Next year a crucial party congress will anoint a new generation of leaders, led by Xi Jinping, now the country's vice-president, to take over the running of the country. Repression is the job of China's powerful "security state"-the regular and secret police. Sensing rudderlessness at the top, it may be particularly inclined to flex its muscles now.

The fear of hanging separately

Many of China's new leaders come from the "princeling" class, an aristocracy of families with revolutionary credentials from the days of Mao Zedong (see article). Some have lucrative positions which give them a financial interest in tighter party control over both the economy and society. Others use their ideological pedigrees to advocate a neo-Maoist approach, which includes scant regard for the law. There is plenty of resentment within the system at the growing power of this aristocracy, and repression can be used to defang opposition. A nastier China is the result.

In the short term at least, these troubling developments undermine the comforting idea that economic openness necessarily leads to the political sort. All the more reason, then, for the West to hold China to account. America and the European Union are right strongly to condemn Mr Ai's detention, though it would have been better had they taken a stand sooner. Speaking out might just help constrain the regime's behaviour. It will certainly give succour to those in China working bravely to create a better future.

Index | Leaders

Nigeria's successful elections

Democracy 1, vote-rigging 0

Gambling on the world's most expensive voting system has paid off



ANYONE who has received a Nigerian scam e-mail-offering to share vast wealth in exchange for just a teensy bit of advance capital-will instantly grasp how rife corruption is in Africa's most populous and entrepreneurial country. This is true of politics as well as commerce. Cheating has become so brazen that few Nigerians expect fair elections. Politicians have for years larded voter lists with the names of foreign musicians, including deceased ones like Marvin Gaye, and have stuffed ballot boxes with abandon.

At parliamentary elections on April 9th, allegations of rigging were once again in the air. Violence also flared up. And the late delivery of ballot papers, which were securely printed abroad, delayed the voting by a week. Nonetheless, the poll marked the first credible election in Nigeria since the end of military rule 12 years ago (see article).

What made it different is that officials fought back hard for the first time. They introduced a new voting system that severely limits fraud, using a clever mix of high-tech and low-tech. All 73.5m voters were fingerprinted and screened to stop duplication. Most polling booths opened for only an hour to prevent multiple voting. Electoral officials tallied the results in front of the voters. Independent monitors collected the numbers instantaneously using mobile phones in an exercise called "crowd tabulation".

The process has been expensive: the government has set a record for public spending on elections of $580m. Western donors argued at first that the system was too complex for a developing country to handle. They were wrong.

The credit goes mostly to two men. The first is President Goodluck Jonathan, who is himself standing for re-election on April 16th. He may thus benefit personally from the reforms, but he acted against the interests of his party, which had perfected the dark art of rigging. The second is Attahiru Jega, head of the official election commission, who designed a voting system that angered many powerful lobbies. Together they have given new hope to the many Nigerians who are embarrassed that their vibrant country, often ranked as the most optimistic in the world, has become a byword for swindling and fraud.

More has to change before Nigeria's political leaders can claim full legitimacy. The elections may be more transparent, but governing still takes place largely behind closed doors. The legislature remains too weak. The Official Secrets Act, which makes it illegal to publish government data independently, needs reform. So do the courts, which are suspected of bias and corruption. Legal challenges after previous elections have failed to produce a single conviction for electoral fraud.

Fit for export

Better elections should in the end help resolve Nigeria's existential question-whether this wildly diverse country of 150m people from 250 ethnic groups created by British colonial masters can work. But ambitious talk of taking over regional leadership is premature. Nigeria should first try to close the democratic gap with South Africa, the continent's top dog, as well as improve its scam-ridden economy.

The best way for Nigeria to show leadership is to help its neighbours to stop rigging their polls. Not all have the right staff or can afford high-tech answers. But as countries from Cote d'Ivoire to Kenya have found, bad or contested elections can be the costliest mistakes of all.

Index | Leaders

Britain's banking commission

No more walks on the wild side

Britain decides not to reinvent banking. Good



BECAUSE banks loom so large in the national economy, Britain decided it needed to go its own way and design a bespoke system for regulating them. This week the commission asked to do that, chaired by Sir John Vickers (pictured), gave its first recommendations (see article).

Sir John has not offered a radical departure, but a beefed-up version of what the rest of the world is doing. Compared with other banks, British ones would have to ring-fence their vital parts and carry more capital, and they would also face more action to promote competition. His proposals could do with a bit of strengthening, but are broadly to be welcomed.

For some Britons, however, this approach is nothing like tough enough. They want a Year Zero in which officials design a safe financial system from scratch, banks are broken into smaller pieces and their high-street operations severed from their investment arms.

Such notions turn the crisis into a comforting morality tale in which bankers are met with the same violence they unleashed on an otherwise healthy economy. But society's pact with finance is grubbier than this. Those cheap loans went somewhere, and the banks' risky levels of debt partly reflected Britain's habit of borrowing more than it saves. The country benefits, as well as suffers, from hosting a financial centre. Its global firms can be useful as well as dangerous.

Britain is also an example of how heterogeneous bank failures were. No clear link exists between the size or type of firm and failure. Those who idealise a patchwork of traditional banks should look at Spain, whose bust savings banks are now being merged to try to make them safer.

Instead of predicting what types of banking are safe, the Vickers commission observes that some kinds are worth bailing out more than others: namely, banks' high-street arms and the payments systems that people rely on. It reckons these should be ring-fenced within banks; that way, the state could swoop in and save them alone. Banks' other activities would lose the implicit guarantee that lets them borrow cheaply.

Defining what is virtuous is hard, though. Would big industrial firms be allowed to collapse because their banks had gone under? Even banks' cuddly bits rarely balance their loans and deposits; the shortfall has to be borrowed, or surplus invested, linking them to the rest of the bank and the wider world. Ring-fencing is worth a try, but in a crisis its neat boundaries may be ditched to stabilise the system.

That is why the heavy work must be done by banks' capital buffers. Here the commission pulls its punch: it demands a core capital ratio of 10% for banks' retail arms (compared with 7% under the new international Basel rules) but merely suggests it for their global operations. It should require this ratio for both parts, whatever international regulators (now debating the surcharge for big global firms) may do. The report also demands a layer of debt that regulators can convert into equity if need be. If this were in line with the Basel rules it would take the total ratio to 13.5%, easily enough to have

dealt with the losses of Britain's worst blow-up, HBOS. But given that some firms elsewhere lost more, when it makes its final report in September, the commission should demand more convertible debt than the new Basel rules do.

Vickers and a twist

Lastly, the commission should bolster its line on Lloyds Group, the elephantine product of a state-sponsored merger during the crisis. It is impractical to reverse the merger, but the commission should say by how much Lloyds should be shrunk. Getting its market share below 20% is not a bad objective.

If these changes are made, the government should back the final Vickers proposals. Two other things must then happen. The Bank of England must get a grip on its new job of supervising the banks. And the banks should stop whingeing. Their threats to emigrate are even less convincing after Vickers. Instead, they must start to adapt to the new world. As our briefing on Britain's biggest bank, HSBC, shows (see article), they have lots to do.

Index | Leaders

India and foreign investment

Fling wide the gates

India should throw off its caution about opening up to foreign investment. The benefits would be huge



INDIA'S national monument, in New Delhi, is a tall, broad gate. That is ironic, for the country is hard for foreigners to enter, whether they be individuals trying to get a visa or businesses trying to invest.

India's inaccessibility is unfortunate because, to bridge the gap between its weak domestic saving and its high investment needs, it must import capital, especially foreign direct investment (FDI), the least flighty kind. Yet the latest figures are going in the wrong direction. Last year India got just $24 billion in FDI, down by almost a third on 2009. Globally, FDI was flat over the period.

The glacier moves

There are many reasons why foreign companies are put off India, from corruption and bureaucracy to the difficulty of obtaining land. These are problems that must be fixed for the sake of local, as well as international, businesses. But in too many areas foreign firms remain barred from entering the country altogether-railways and legal services, for instance-or are restricted to minority stakes-such as insurance and domestic airlines.

Indian officialdom realises this must change and, at the pace of a Himalayan glacier, has been opening up. From this month, for instance, foreign firms are allowed into a wider range of agricultural businesses. But many other such reforms are stuck. Given the huge benefits that liberalisation could bring to India's 1.2 billion people, the government should pluck up courage and fling wide the gates.

India's primitive and wasteful retail industry is the most glaring example of the need for foreign investment. The business is dominated by tiny mom-and-pop stores. The near-absence of big supermarket chains means there is no "chill chain" of transport and storage to keep fruit and vegetables fresh from field to shopping-basket. As a result, a quarter or more of such produce is wasted, a catastrophe in a country where so many go hungry. In more advanced retailing systems, less than a tenth is lost. Some big Indian firms are moving into the business, but what is needed is to lift the remaining restrictions on foreign ownership and let in international experts such as Walmart, Tesco and Carrefour.

Retailing employs more than 30m Indians, so some fear social unrest if the admission of foreign chains puts small shops out of business. But given India's rapid growth there is plenty of space for supermarkets to expand without killing small stores (see article). Indeed, the tiddlers would be better off buying their supplies from foreign supermarkets than from the inefficient, costly middlemen they rely on now. In any case, such worries are greatly outweighed by the potential benefits to Indian consumers: lower prices and better quality, choice and nutrition. Economists in America talk about the beneficial "Walmart effect" that the ubiquitous cheap chain has had on curbing prices. Indians, as they fret over soaring food costs, might find such a thing a godsend.

Given the success some Indian companies are now having on the world stage, India's fear of foreign competition at home seems odd. It is time for the country's politicians to sweep away such protectionism for good, and declare that India is as ready to take on the world in business as its World Cup-winning team is in cricket.

Index | Letters

Letters

On Cyprus, intervention, political dynasties, the state, companies as people

---

Letters are welcome via e-mail to letters@economist.com

Stalled talks



SIR - I sensed a dubious reluctance in your article ("Sad island story", April 2nd) to pinpoint where responsibility lies for the "gloom" that has settled over the Cyprus talks. A year ago you did not describe Dervish Eroglu, the Turkish-Cypriot leader, in the brightest of colours ("a nationalist hardliner", against "a bizonal, bicommunal federation"). Yet given that he has since been consistent, your silence now is striking. It would be naive to believe that emerging pessimism is unrelated to your then quite accurate description.

By the same token, mention of Turkey's responsibility in preventing progress in the talks is equally absent. When you did bring it into the picture, it was the epitome of euphemism. Two out of the three unilateral measures you quoted are in essence long-overdue legal obligations of Turkey (opening its ports to Cypriot trade and the return of Varosha). The third, allowing flights to Ercan "airport", would be tantamount to breaching international law and to an upgrade of the illegal regime in the north, thus removing any motivation from the Turkish side for a settlement.

Nor is your conclusion, using the Greek translation of "give and take" (take and give), substantiated. Indeed, while convergence on the structure of a federated Cyprus has been recorded, due to President Christofias's bold and courageous proposals, on issues like property, territory and security, where incidentally Turkey has to compromise, the picture is the reverse. It sounds more like being faced with the logic of asking for everything in exchange for nothing.

Yiorgos Christofides
Deputy high commissioner for Cyprus
London

Time to step up



* SIR - It is disturbing to see Germany shrink from responsibility because of its discomfort with military forays ("No illusions", March 19th). But it is equally disturbing that leaders of democratic Eastern European nations have chosen to do little as the Arab spring unfolds. The people of Poland, the present Czech Republic, the Baltic states and others struggled long against the oppressive Soviet regime. Before they won their freedom just over 20 years ago, they saw their chances crushed repeatedly in uprisings against their communist masters. Today, these countries are in a special position to provide visible leadership on events in the Arab world and to support of the legions of people risking their lives for the hope of democracy. Yet they are not participating in the military action in Libya, and their leaders are virtually mute on the world stage.

Stacey E. Blau
Miami

What's in a name?

SIR - It is true that family names matter in politics in Latin America ("Kin selection", April 2nd), but do the names Clinton, Bush, Kennedy, Le Pen and Royal-Hollande not remind you that this phenomenon occurs in other more developed countries? Should we conclude that politics in those "benchmark democracies" has also become "the latest family business"?

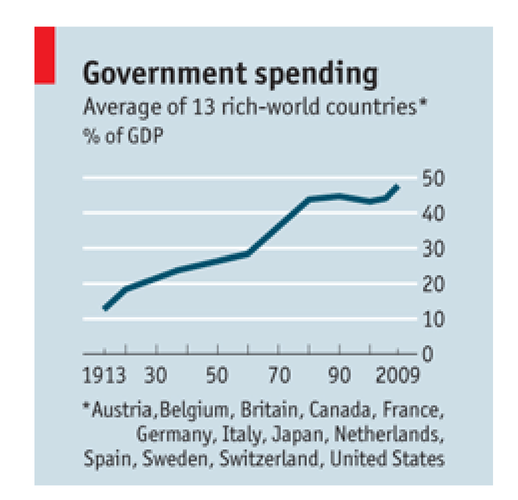
Nelson Camanho
London

Reining in the state

SIR - In regard to your special report ("Taming Leviathan", March 19th), arguments for a smaller state abound. However, there is one advantage of public spending: institutions financed by the state need not tailor their offers to the market. Consider two examples: the BBC and British universities.

The BBC, as it is financed by a regular income and through state support, can afford to show niche, high-quality programmes. Private channels are reluctant to do this because they fear that they may not be watched by enough people. Similarly, state-funded universities can offer non-mainstream degree programmes, rather than only what is commercially successful, ie, sciences and economics. Shrinking the state could lead to an impoverishment of diversity and a loss of freedom.

Mario Bisiada
Manchester



SIR - You twice mentioned-and then went on to ignore-the Baumol cost effect: the same number of musicians are needed now to play a Beethoven symphony as in the 19th century, even though real wages for musicians have since risen.

But William Baumol was an optimist. A better analogy would be an orchestra whose musical instruments steadily increase in size, so that they are soon too large to manipulate without motors and computers. Eventually a larger concert hall is required to accommodate them. The new hall is, of course, equipped with "dynamic acoustics", which can be tailored in real time to the music being played. This, in turn, requires teams of engineers and computer technicians, as well as mechanical hoists and their operators, to move the instruments.

This works until the instruments reach such a size that their (ageing) players can no longer manoeuvre them single-handedly and more musicians must be employed. And another hall built. Such is the nature of the pressure on health care and pension costs imposed by accelerating developments in medicine. It is a structural problem, which cannot be solved by pretending it doesn't exist, or that it's just a matter of "catching up" with private sector productivity.

Monty Maclean
Stockholm

SIR -You said the recent economic crisis had resulted in "far greater acceptance that government is broken", and that states should emulate private enterprise. Strange. After the crisis I believe most drew the conclusion that private enterprise, and in particular private financial industry, was broken and had to be rescued by the more efficient and rational state.

Thomas Nowotny
Vienna

* SIR - Your special report lacked an explicit statement of the economic role of government. Abba Lerner spelled it out in 1944 in "The Economics of Control", asking that each activity be expanded until its added social benefits fail to exceed its added social costs. Between the two are five equations, each of which implies a role for government unless competition

and market forces fail to do the job. The social versus net benefits and costs imply externalities, about which economists have written much. But the private versus social benefits can only be equal if consumers are informed and insightful and the distribution of purchasing power is not too unequal. And of course, monopolies matter.

Unfortunately you failed to deal with areas where competition cannot work, and where there is a choice between government run operations, with inadequate incentives for efficiency, or regulated public utilities with difficulties. You implied that governments should not run ports or water systems, where surely a single operator makes sense. Distribution grids for electricity, gas, rubbish and water are natural monopolies, where competition makes no sense. With a regulated monopoly providing the distribution, there can be competitive suppliers, and competing customers, with difficult pricing problems. You gave only passing mention to the possibility of naming-and-shaming as an incentive, even if customers would have difficulty switching to a different provider. A systematic publication of representative sample surveys of customers makes sense.

Health systems have both. Major medical episodes and long-term care cannot efficiently count on competitive insurers because of self-selection by customers and cherry-picking of safe ones by insurers. Strangely, no one has suggested cutting off the upper tail of the cost distribution for separate treatment with compulsory coverage, and perhaps competitive provision of insurance. That would allow competitive insurance for the rest of medical care, and relieve state Medicaid budgets, of which about half are for long term nursing care.

Jim Morgan
Ann Arbor, Michigan

SIR - You mentioned that Hank Paulson took a 99.5% pay cut. That may be true from a nominal perspective, however Mr Paulson saved $50m in capital-gains taxes because of a law passed by George Bush senior that exempts capital gains incurred by those selling investments to move into the public sector. He was also able to dump all securities shortly before the financial system imploded (without regulators or shareholders causing a fuss), so it was more like early retirement on the back of an extremely prudent financial decision than a pay cut.

Marc Gayle
Kingston, Jamaica

SIR - In your article, you reported that "the only American public-sector workers who earn well above $250,000 a year are university sports coaches and the president." This is inaccurate. According to SeeThroughNY.net, there were 455 public-sector employees in New York state who were paid over $250,000 in 2009, including a professor making $734,000 and the head of a library earning $689,000. Nearly 110,000 public employees received over $100,000. There is no lack of highly paid public-sector jobs. Capping pay at $100,000 a year would save $2 billion in the first year, plus pension savings, and there are plenty of competent people willing to take such government jobs.

Warren Redlich
Albany, New York

Companies and court



SIR - Schumpeter (March 26th) mentioned the Supreme Court ruling in *Santa Clara County v Southern Pacific Railroad* in 1886 that companies enjoy the protection of the 14th amendment. In fact, the court expressly declined to rule on the

point because of a fear that the decision could be grounded on a non-constitutional basis. The idea that the court ruled on it comes from a headnote by the court reporter, which reflected a colloquy between the chief justice and counsel prior to the oral argument, but which is not part of the decision.

Thomas Schneider
Retired administrative law judge
Menlo Park, California

SIR - If companies have the same rights as people then they should also be able to go to jail. Or at least be put under constant electronic control. Schumpeter has opened up an interesting new field.

Einar Hellbom
Jarfalla, Sweden

* Letter appears online only

Index | Briefing

Central America

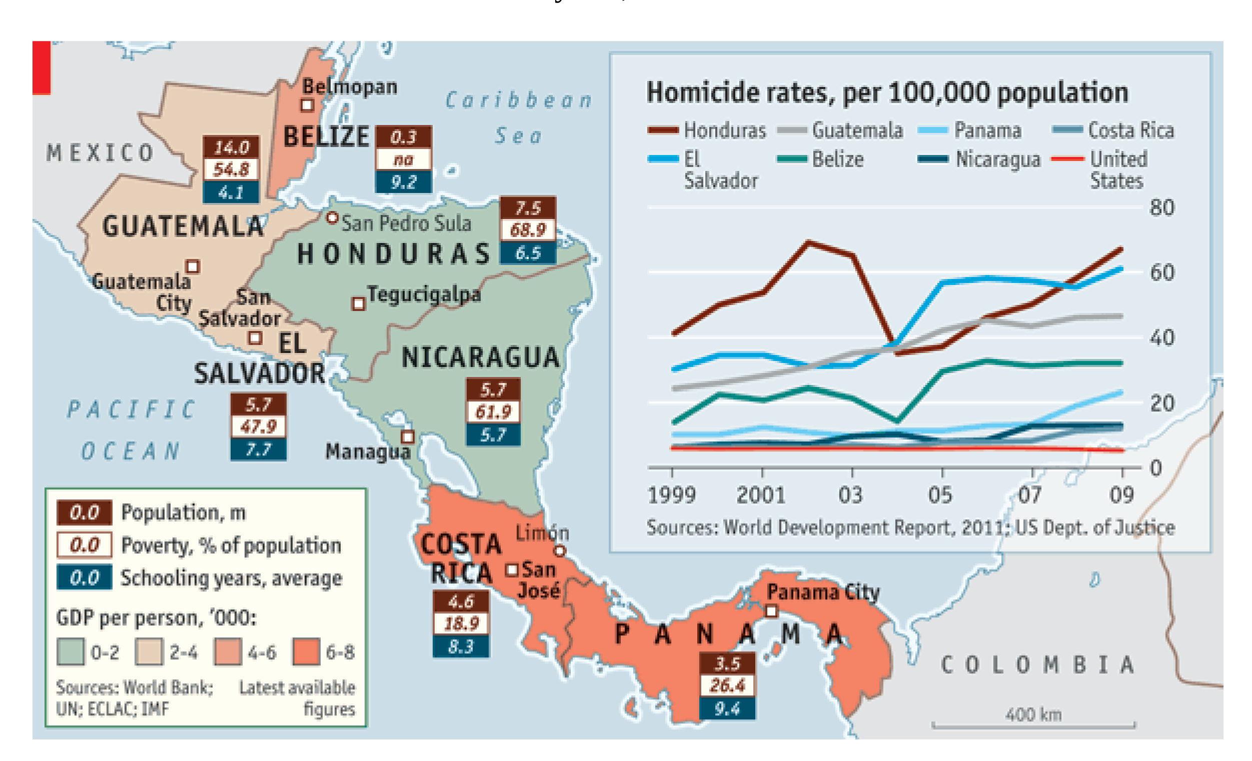
The tormented isthmus

Big-time drug trafficking has arrived in Central America. Its poor, politically polarised countries must now try to cope



WHEN Eduardo's father came back to Guatemala after a spell in the United States, the tattoos up his arms gave away his roots in the *mara* (gang). Before long a rival gang had planted a knife in his back; when that failed to kill him they returned to finish him off in the street near his home. Eduardo (not his real name) was only eight at the time. But to avenge his father he joined his gang as a *sicario* (hitman), and killed his father's murderer. Eduardo is now trying to find out whether life can offer any of the happiness he says he has never known. Since January he has been studying computing with La Ceiba, an NGO. As for that murder: "I enjoyed it," he says blankly.

The bullet scar on Eduardo's chest and the beaten right arm hanging limply by his side are signs of the violence that has come to engulf Guatemala and much of the Central American isthmus. No region on earth is more routinely murderous. Guatemala's rate of 46 murders per 100,000 people is more than twice as high as Mexico's, and nearly ten times greater than that of the United States. Honduras and El Salvador-the other two countries that make up Central America's "northern triangle", as it is called-are more violent still (see chart in map). Nicaragua, Costa Rica and Panama, the quietest members of the group, have also seen violence increase in recent years, as has Belize.



These man-made tragedies are matched by natural disasters. Four of the seven Central American countries are among the 20 reckoned to be the most vulnerable in the world to destructive weather. Hurricanes, floods, landslides, earthquakes and volcanic eruptions are frequent and deadly events. They add to the steady grind of poverty and malnutrition.

Costa Rica and Panama are much better off and better governed than their neighbours. Costa Rica is one of the world's oldest democracies; life expectancy there is on a par with the United States. The others have suffered torpid economic growth in the past decade. Nicaragua is the poorest country in mainland Latin America. Almost half of Guatemala's children are chronically malnourished-a rate worse than Ethiopia's, and said by the World Bank to be the third-worst in the world. The damage is visible. Eduardo the ex-*sicario* looks much younger than his 18 years; as he recounts his murderous apprenticeship, he shuffles child-sized shoes.

Political conflict compounds these problems. The civil wars that ravaged Central America in the 1970s and 1980s between dictators backed by the United States and guerrillas backed by the Soviet Union and Cuba are over, but a crippling polarisation of right and left remains. In 2009 the president of Honduras fell victim to a coup prompted by fears-or paranoia-about his ties to Venezuela's Hugo Chavez. This year will see a bitter election in Guatemala and a dubious one in Nicaragua, where Daniel Ortega will seek a third presidential term in violation of the constitution.

As if being battered by nature, bad government and youth gangs were not enough, Central America now finds itself thrust into the front line of the drugs trade and prey to big-time organised crime. Nearly all the world's cocaine is produced in Colombia, Peru and Bolivia. The biggest consumer is the United States, where the wholesale price of a kilo of the stuff, even full of impurities, starts at $12,500. The route to market used to run from Colombia to the tip of Florida, across the Caribbean. But the United States Coast Guard shut down that corridor by the early 1990s, and shipments switched to the Pacific coast of Mexico. Now Mexico, too, has increased the pressure on the traffickers, just as Colombia has done in the south.

Ever supple, the drugs business has sought new premises. Somewhere between 250 and 350 tonnes of cocaine-or almost the whole amount heading for the United States-now pass through Guatemala each year, according to American officials. Whereas a decade ago Central America seized less cocaine than either Mexico or the Caribbean, in 2008 it intercepted

three times more than the other two combined. Mexico's Sinaloa, Gulf and Zetas mobs are now active through much of the isthmus, often with local allies. Unlike the Colombians, they pay their local help in drugs, not cash.



Overwhelmed in Panama

The impact has been lethal. Guatemala's murder rate has doubled in the past decade. In both Guatemala and El Salvador, the rate of killing is higher now than during their civil wars. Guatemala's government reckons that about two-fifths of murders are linked to the drugs business. Even Panama, much richer than many Central American countries and a favourite retirement spot for wealthy foreigners, has seen its murder rate almost double in the past three years.

As well as using Central America as a corridor, the traffickers are moving more of their operations there. "We went through a phase in which we made the mistake of seeing ourselves as a supply transit centre, so we just had to interdict. That's not enough. In Central America drugs are produced, processed and consumed," says Laura Chinchilla, Costa Rica's president. In March, to official surprise, what looked like a Mexican cocaine factory was uncovered in Honduras.

As well as taking lives, insecurity carries a heavy economic cost. All in all, dealing with crime and violence costs Central America around 8% of its GDP, according to a report this month by the World Bank. In the most violent countries, cutting the murder rate by 10% could boost income growth per head by up to 1% a year, the bank reckons. Security-related costs are equal to around 4% of private businesses' sales. Alberto Diaz Lobo of Constructora Eterna, a building firm in Honduras, says his security bill has gone up about 20% in the past five years. Walmart recently moved some of its Central American operations from Guatemala to Costa Rica, partly because of higher insurance premiums caused by insecurity, according to a former manager.

In the northern triangle, weak law enforcement and tracts of wilderness make a perfect environment for organised crime. The Peten, a sprawling, sparsely populated jungle region in northern Guatemala, has become a landing zone for clandestine flights from Colombia and Venezuela. In the Laguna del Tigre national park lies a "cemetery" of more than 30 crashed light aircraft which had been used to ferry cocaine. (The drugs business is so profitable that aircraft are considered disposable.) Locals are paid by narcos to keep the runways open, and sometimes clear more themselves to attract business.

The government does not have the resources to police such an area. Under the peace agreement of 1996 that ended the guerrilla war, the country was supposed to slash the army and expand the police. Only the first happened. The army was cut by two-thirds, but the police force of 25,500 is less than half the size required, says Carlos Menocal, the interior minister. Last year Alvaro Colom, the president, declared a state of emergency in the northern department of Alta Verapaz

and sent in the army. He claims that only two drugs flights have landed there since, whereas "before it was like an international airport". The state of emergency was lifted in February. But Mr Colom concedes that there are still four areas of the country where the drug barons have "temporary control". To recover them he would need 10,000 more soldiers and 15,000 extra police, he says.

Honduras ordered the army on to the streets of its cities in March; El Salvador did the same last September. Costa Rica abolished its armed forces in 1948. Its 11,000 police are "badly trained, badly armed and equipped and badly housed", admits Jose Maria Tijerino, the interior minister. Plans to recruit an extra 1,000 officers a year for the next four years will still not be enough, he says. The entire force has two two-man helicopters. Its coastguard has a dozen second-world-war-era patrol boats to police two coasts and territorial waters that are 11 times bigger than the country's land area.

Education and the lack of it

Organised crime feeds on Central America's other weaknesses. In several of the countries these start with the economy. This has traditionally been based on the export of coffee and other crops. In the 1990s foreign investors set up textile factories to supply the United States market. Nevertheless, income per head in the northern triangle, plus Nicaragua, rose by 1.6% a year between 1995 and 2009, barely above the Latin American average of 1.5%. Central America's ties to the United States meant that it was badly affected by the recession. It also depends on imported oil and food. As commodity prices rose, poverty increased in the region even before recession struck.

By contrast with its neighbours to the north Costa Rica remains a success story, though not without problems. It is more egalitarian than the others, and since the 19th century has made an effort to educate its people. After opening up its economy in the 1980s, Costa Rica saw foreign direct investment and exports flourish. It is now home to an Intel silicon-chip plant, a cluster of medical-equipment manufacturers and back-office operations of multinationals such as Hewlett-Packard and Procter & Gamble. "This was an educated country that had no economic use for that education," says Alberto Trejos of INCAE, a business school. "Now foreign investment has turned education into a key comparative advantage." If Costa Rica faces a shortage of engineers and English-speakers, that is a problem of success. Panama is doing something similar by using its canal to turn itself into a regional business hub.

Contrast that with Guatemala, home to a third of Central America's 42m people. It has a few institutions that work reasonably well, such as the central bank and the private universities. But it has failed to invest in its people. Recent governments have made some effort. But the average Guatemalan has just 4.1 years of schooling. The shocking prevalence of malnutrition rises to up to 80% of children in some rural villages. The health and schooling of the 45% of the population who speak a Mayan language has been especially neglected. Mr Colom admits to "shame" over that, but few other Guatemalans seem to.

In a vicious circle of opportunity forgone, most Central American countries fail to generate enough jobs for their unschooled people. Only 27% of Central Americans (and just 10% of Nicaraguans) are enrolled in their national social-security systems, according to Miguel Gutierrez Saxe, a Costa Rican economist who compiles regional data. The rest labour in the informal economy, or are among the 11% of youths who neither study nor work. This idleness feeds the *maras*: in El Salvador some 800 juveniles languish in jail, more than double the number in 2004. At least 15% of Central Americans (6m of them) have emigrated, most to the United States.

One way of injecting more dynamism into Central America's economies would be by improving transport links and cutting red tape. Astonishingly, it can be cheaper to ship goods to the United States from China than from Central America, according to a World Bank study. Border hold-ups and bottlenecks through towns mean that it can take up to five days for a truck to travel the 870km (540 miles) from Guatemala City to San Jose. Some 80% of Costa Rica's exports and imports, and a chunk of Nicaragua's, pass along a single-carriageway road and a modest wharf at the run-down Caribbean port of Limon.

But governments are now struggling just to maintain existing infrastructure. Central America has long suffered natural disasters. But these now seem to be more frequent-something its leaders attribute to climate change. After a severe drought in 2009, Guatemala suffered its worst recorded flooding last year; together these caused losses of $1.5 billion, according to Mr Colom. Between 2005 and 2009 natural disasters cost Costa Rica 0.8% of GDP, equivalent to around 18% of public investment.

States without cash

While the demands on governments multiply, their cash does not. Even by Latin American standards, the state in Central America is weak and poor. In Guatemala the tax take is just 10.4% of GDP. To reach Costa Rica's social indicators of 2010 would need a tax take of 18% for ten years, reckons Edelberto Torres Rivas, a consultant to the UN Development Programme.

But fiscal reform is a hostage to Guatemala's political deadlock, blocked by the country's powerful business lobby. Businessmen complain, reasonably enough, of government corruption and say that the civil service needs reform. But their implacable opposition to a modest cash-transfer programme for the poorest, implemented by Mr Colom's wife, Sandra Torres, betrays a complete lack of social solidarity. The contrast with Colombia is instructive. Alvaro Uribe, Colombia's stern former president, who made his country safer and also implemented a similar transfer programme, has become the hottest conference speaker in Central America. Businessmen in Guatemala last October loudly applauded his message about security; but when he exhorted them to pay their taxes, he was met with silence. Even in Costa Rica, "Tax evasion is the national sport," says Ofelia Taitelbaum, the ombudsman.

That is partly because the better-off in Central America make private arrangements not just for health and education but for security. Private security guards are reckoned to outnumber the police and the army by a ratio of about five to one in Guatemala and four to one in Honduras. Everyone pays for protection, "including the poor, who pay for poor security", according to Pedro Trujillo, a former colonel in the Spanish army turned political scientist at Francisco Marroquin University in Guatemala City. He found that in the 12 years following Guatemala's peace accords in 1996, 110 private security firms were registered in the country; the previous three decades had seen fewer than 40. In San Pedro Sula, the economic capital of Honduras, the chamber of commerce reports that security is the biggest cost for its members after manpower and electricity.



Change can come only through political consensus. But Central America's political systems are nearly all dysfunctional. Nicaragua's democracy has been castrated by Mr Ortega, whose party orchestrated widespread fraud in local elections in 2008. In Guatemala, no political party has held office for more than one presidential term since democracy was restored in 1986. By contrast, in El Salvador it was only in 2009 that the opposition managed to end two decades of rule by Arena, a powerful conservative party. The new president, Mauricio Funes, is a moderate left-winger; he must battle against his own party, many of whose leaders are pro-Cuban. Honduras has paid a high price in lost aid money and investment for its political strife.

Panama has built an increasingly solid democracy since American troops overthrew General Manuel Noriega in 1989, but its politics have been marred by corruption and high-handedness. Even Costa Rica faces political problems. A stable two-party system broke down when one of the parties, the Social Christians, imploded after corruption scandals. Lacking a majority in Congress, Ms Chinchilla faces a struggle to win approval for extra taxes to pay for her modest security build-up.

Not everything is gloomy in Central America. The Central American Common Market has survived political conflicts among the neighbours-including an incursion into Costa Rican territory last year by Nicaraguan troops. Most countries are making efforts to respond to the security threat. Honduras last year passed an asset-seizure law, copied from Colombia. In Guatemala, a UN-sponsored anti-impunity commission, known by its Spanish initials as CICIG, has secured such innovations as wiretaps, plea-bargaining and witness protection. But the country still lacks a computerised intelligence

platform. The World Bank cites estimates of 2m guns in the country, of which less than 10% are legally registered. And Francisco Dall'Anese, CICIG's head, has faced a campaign of vilification from businessmen.

Uncle Sam's role

Not surprisingly, Central America's leaders think the United States should do more to help tackle the consequences of its own demand for cocaine. Though the region is more violent than both Mexico and Colombia, Central America receives much less American aid. The Central American Regional Security Initiative, the latest aid scheme, offers just $260m over three years to the seven countries. "A drop in a bucket," says Ã“scar Alvarez, Honduras's security minister. "Costa Rica is not a country that goes begging," says Ms Chinchilla. But she is frustrated that when the Americans come to help, "they always arrive late. When they give significant aid it's when countries have been invaded by organised crime. They think Nicaragua, Costa Rica and Panama are OK." Seizures of drugs are neither a good measure nor a good solution to the problem, she says.

The Obama administration has at least shown "an understanding that the problem isn't just ours," says Mr Colom. "They are looking for a different plan, because the plan they already have isn't working," he believes. Though American officials stress that the strategy will come from Central America and not from Washington, there are some signs of a shift in thinking. William Brownfield, a former ambassador to Colombia who is now the State Department's top anti-drug man, visited Guatemala, Honduras and El Salvador in February, his first trip in his new job. Mr Obama visited El Salvador in March, when he announced a modest increase in anti-drugs aid to the region, if Congress agrees. There is a feeling that in the isthmus, aid delivers "more bang for your buck" than in Mexico or Colombia, one diplomat suggests. With cash scarce in Washington, aid may be redistributed rather than increased.

Some things are getting better in Central America. But the problem, as an American diplomat in the region says, is that whereas the improvements are linear, the threats are growing exponentially.

Index | United States

Grappling with the deficit

Rival visions

Barack Obama lays out his own plans for the future. They have little in common with those offered by the Republicans



AFTER months of inconclusive skirmishing, Washington's budgetary battle-lines are being drawn in earnest. Neither the Republicans nor the Democrats won outright victories in December's set-to over taxes or last week's showdown over the budget for the remainder of this fiscal year. Moreover the stakes were tiny relative to the task at hand (see chart). But with Barack Obama giving his response on April 13th to the long-term budget plan unveiled a week earlier by the Republicans in the House of Representatives, both sides are now fully engaged. Their ideas about putting America's finances to rights, although vague, are starkly opposed.

Still quite a gap

Reduction in deficit resulting from agreed spending cuts of $78.5 billion

$1.6 trillion
Deficit implied by Obama's 2011 budget proposal

0 0.2 0.4 0.6 0.8 1.0 1.2 1.4

Mr Obama produced an only slightly less ambitious goal for deficit reduction than the House Republicans, albeit working from a more forgiving baseline: $4 trillion over 12 years compared to $4.4 trillion over 10 years. But the means by which he would achieve it are very different. Whereas the Republicans want to cut taxes, Mr Obama would raise them by more than $1 trillion. He wants to further strengthen his health reforms, which the Republicans want to scrap altogether. He proposes cuts in military spending-the one area where Republicans were reluctant to swing the axe. Much like Paul Ryan, the congressman who drew up the Republican plan, Mr Obama seems to have embraced the supposedly bipartisan goal of deficit reduction, but by means calculated to reassure his base and outrage his opponents.

Indeed Mr Obama spent much of the speech in which he described his plan spelling out his differences with the Republicans and denouncing the vision of America embodied in their proposal. Wealthier Americans, he reiterated several times, should pay more in taxes, not less; poorer ones should not bear the brunt of spending cuts. The Republican proposals, he claimed, would deprive 50m people of health insurance, leave bridges and roads to crumble unrepaired and allow such countries as Brazil, China and South Korea to surpass America in education and technological know-how, all for the sake of lowering taxes on the rich.

Instead, Mr Obama proposes to cut spending by $2 trillion and increase taxes by $1 trillion, all of which would save $1 trillion in extra interest payments, the White House calculates. Of the spending cuts, $400 billion would come from the armed forces, $480 billion from health care, $360 billion from other recurring items such as agricultural subsidies, and $770 billion from the "discretionary" part of the budget, meaning the spending that must be renewed each year. All the extra revenue would come from eliminating loopholes in the tax code. Mr Obama also said he would allow taxes on the rich to rise in 2012, as they are currently slated to do (but not on everyone else, as they are also slated to do). But since he was already assuming that that increase would go ahead, despite Republican vows to stop it, it is not included in his numbers.

Perhaps the starkest difference between the two plans concerns health care. Mr Ryan proposes to give older Americans vouchers to buy private insurance, instead of paying for the lion's share of their medical bills directly. The value of the vouchers would rise more slowly than medical costs have done of late, however, leaving the elderly footing more of their bills. Mr Obama says that he refuses to leave seniors "at the mercy of the insurance industry, with a shrinking benefit to pay for rising costs". Instead, he would try to tackle medical inflation head on, by giving more power to the cost-control board set up as part of the Democrats' health-care reforms. But it is not at all clear that the board would in fact be able to find savings of the magnitude Mr Obama envisions without reducing the quality of care or passing more costs along to patients.

That is not the only instance in which Mr Obama has left the fine print to others. The defence cuts would be determined by a "fundamental review" conducted by the top brass. Big savings from Medicaid, the health-care scheme for the poor that Mr Ryan wants to entrust to the states, will somehow be achieved in consultation with governors, but without the federal government ceding control. Most glaringly, Mr Obama provides neither the details of the tax reforms he has in mind, nor a mechanism for drawing them up.

In theory, the president's framework, as he called it, makes allowance for the fact that some of his woollier proposals may not yield the desired results by means of a "fail-safe" mechanism. It would institute across-the-board spending cuts from 2014 should the national debt continue to grow faster than the economy. Republicans are keen on such schemes in principle. But they have a poor record in practice, as they tend to be overridden by Congress. Worse, Mr Obama wants to count tax breaks as spending (which can be cut), and to exclude expensive social programmes from the automatic reductions-steps that transform the concept from a peace offering to a provocation in Republican eyes.

Sure enough, Republicans wasted no time in denouncing Mr Obama's ideas as hollow, timid and partisan-an unconstructive declaration of class warfare. Before he had even revealed them, many insisted that they would not countenance any tax rises. Doctrinaire Democrats, for their part, complained that the president is too willing to cut social spending, and too reluctant to tax the rich to pay for them. It does not help that zealots on both sides are still smarting from the deal the president and the leaders of both parties in Congress struck on April 8th to cut spending in the current fiscal year.

However, Mr Obama himself acknowledges that his plan is only an opening bid, unlikely to become law in its present form. And the deal over this year's budget suggests that the leadership of the two parties, at least, is not bent on confrontation. On the contrary, they found a shrewd formula to accommodate one another. The cuts, of $78.5 billion, were close to the $100 billion, the Republicans had demanded. But they were mostly confined to the areas the Democrats found least painful.

It may be precisely because Mr Obama anticipates fierce haggling with the Republicans over the next few months that he conceded so little ground in his speech. The Republicans, in turn, are threatening financial chaos by refusing to raise the cap Congress sets on the federal government's borrowing, even as the debt nears the $14.3 trillion limit, unless Mr Obama concedes ground on the budget. A bipartisan group of senators, meanwhile, continues to work on a deficit-reduction scheme inspired by the fiscal commission set up by the president last year. Their proposal, likely to be unveiled in May, will probably fall somewhere between the president's and the House Republicans'. A detente is still possible, despite all the martial rhetoric.

Index | United States

The Republican nomination race

The flawed favourite

Last time's runner-up quietly re-enters the fray



The new, improved version

EVEN before Mitt Romney announced this week that he was taking the first official step towards running for president-forming an "exploratory committee"-he was already being called the "nominal" front-runner for the Republican nomination. He came second last time (depending on how you count), and is rich, well organised, articulate and presentable. Normally that would be enough to secure the nomination, since Republican primary voters tend to reward candidates who dutifully wait their turn. But Mr Romney suffers from so many handicaps that pundits feel obliged to qualify his lead. The fact that some polls show him behind Mike Huckabee or even, bizarrely, Donald Trump, only increases the need for qualification.

During his previous run for president Mr Romney could not shake off his reputation as a flip-flopper. In order to curry favour with conservative voters he clumsily disavowed the liberal views on abortion and gay rights he had espoused to become governor of strongly Democratic Massachusetts in 2002. Worse, as governor Mr Romney signed into law an overhaul of the state health-care system which was in many ways a template for the federal health-care reforms that have earned Barack Obama such opprobrium on the right. Mr Romney tries to gloss this over by saying that what worked in one place won't necessarily work elsewhere; but many Republicans regard the principle of requiring people to buy health insurance, key to both the Massachusetts and Obama models, as downright unconstitutional. Mr Obama still mischievously acknowledges his debt to Mr Romney from time to time.

Mr Romney is also a Mormon-a sect viewed with suspicion by the evangelical Christians who make up the majority of caucus-goers and primary voters in several states with early contests. And he can be a wooden campaigner, dressing in forbidding suits and struggling to chit-chat.

Mr Romney signalled how he might try to overcome these obstacles in the brief video he posted online announcing his exploratory committee. In it, he dresses casually (no jacket or tie) and speaks directly to the camera with square-jawed conviction, making no mention of health care or troublesome social issues. Instead, he focuses almost exclusively on employment. He points out that he had a long and successful career as a businessman, providing livelihoods to many, before becoming a politician. Mr Obama and his coterie, he says, have no idea how jobs are created in the private sector-hence the feeble state of the economy. As president, Mr Romney concludes, he will restore America to greatness by pursuing "a growing economy, good jobs and fiscal discipline".

Mr Romney's record as an entrepreneur is also not without its awkward episodes: Bain Capital, a private-equity firm he helped found, laid off workers at many of the companies it invested in and drove several firms into bankruptcy after extracting handsome profits. But the emphasis on the economy still seems sensible, as voters consistently say it is their chief concern in polls. If there is one thing Mr Romney seems to have learned at Bain, it is how to turn around a foundering enterprise.

Republican economics

The rise of the anti-Keynesians

Paul Ryan's intellectual hinterland

WHEN Republicans proposed slashing billions of dollars from federal spending this year, Democrats circulated predictions by economists that jobs and growth would be hit. John Boehner, the Republican speaker in the House of Representatives, countered with an economic expert of his own: John Taylor of Stanford University. "Nothing could be more contrary to basic economics, experience and facts," Mr Taylor asserted on his blog, which Mr Boehner cited. By cutting government spending, he said, the Republicans would "crowd in" private investment and create jobs.

Mr Taylor, a prominent monetary academic, served under both George Bush senior and junior and advised John McCain during his presidential campaign. In the past few years he has become a strident and prolific critic of the monetary and fiscal stimuli deployed by the Federal Reserve and the Obama administration respectively, views that have received a warm welcome from House Republicans. For if there is one ideology that unites today's Republicans, it is Keynesianism, whose nefarious influence they are determined to stamp out. "Young Guns", the book-sized manifesto of Eric Cantor, Kevin McCarthy and Paul Ryan, leading Republican House members, devotes several pages to the evils of Keynesian activism and its exponents in the administration.

The budget Mr Ryan proposed on April 5th seemed to herald the return of supply-side economics, the notion that cutting taxes can generate so much more work and investment that tax revenues rise. In the 1990s Mr Ryan was a speechwriter for Jack Kemp, the effervescent congressman who, in the late 1970s and early 1980s, made supply-side economics a centrepiece of Republican electoral ambitions.

Perhaps that is why Mr Ryan turned to the Heritage Foundation, a conservative think-tank, to produce a wildly optimistic analysis of his budget's economic impact. It did not say Mr Ryan's cuts to personal and corporate tax rates pay for themselves; though it reckons they recoup a still hefty 50% of their costs. But it projected an investment boom that would lift output and drive unemployment down to 2.8%, a rate not seen for 57 years. Few economists dispute that lower tax rates boost labour supply and investment. But Menzie Chinn, an economist at the University of Wisconsin at Madison, reckons the Heritage Foundation assumes a boost five to eight times more powerful than conventional models.

Supply-side economics, though, is only one piece of Mr Ryan's intellectual furniture. He has also paid homage to Ayn Rand, Milton Friedman, Friedrich Hayek and Robert Mundell, a Nobel laureate who champions the monetary straitjacket of fixed exchange rates. His budget cites approvingly the work of Carmen Reinhart and Kenneth Rogoff on how debt cripples growth and Niall Ferguson, a historian, on how it brings down empires. For on-tap advice Republicans regularly turn to Douglas Holtz-Eakin, a former McCain adviser who now runs the American Action Forum, a think-tank, and Mr Taylor, who keeps a flat in Washington, DC.

Republicans may have found intellectual satisfaction in their opposition to fiscal and monetary stimulus. Whether voters will thank them is another matter. The danger is that, when interest rates are stuck near zero, austerity is more likely to hurt growth than help.

Index | United States

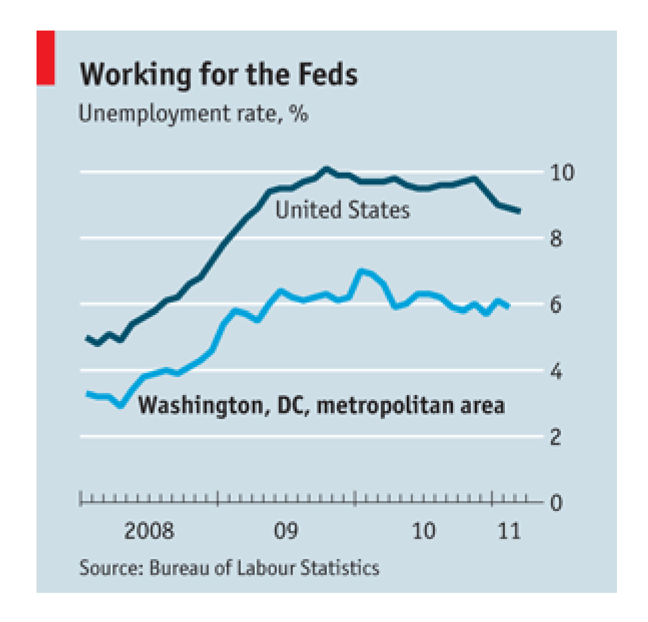
Washington, DC's economy

Blooming

Boom times in the capital



EVERY spring, hundreds of thousands of visitors flock to America's capital to take in the gorgeous vistas of cherry-blossom time. Above the bloom-laden trees, this year's tourists glimpsed a rare sight: cranes towering over downtown Washington and the nearby suburbs. Across the metropolitan area, ambitious building projects are moving forward. Bold developers are once more confident that demand will materialise. While most of America frets over a jobless recovery, the Washington economy is booming.



On nearly every measure, the capital is exceptional. At 5.9%, Washington's unemployment rate is easily the lowest among America's large metropolitan areas. That is down from a recession high of just 7%, well below the national peak of 10.1%.

Employment in the metro area has risen by about 84,000 over the past year-roughly 6% of America's job growth, in a region with just 2% of its population. Incomes are high and rising, and the combination of job and income growth has buoyed a property market that was battered by the housing bust. House values in most cities fell in the year to January, according to the S&P/Case-Shiller index of prices. But whereas an index of prices in 20 large cities dropped 3% during that time, values in Washington rose 3.6%.

To many Americans, the capital's boom mainly reflects the relentless growth of the bureaucratic state. Washington's economy is supported by federal government employment, which is virtually recession-proof. The federal government accounts for 2.2% of all jobs nationally, but for nearly 13% of those in the Washington area. And the capital's primary business did not collapse during the recession as other sectors did. Federal employment in the area rose by nearly 20,000 from the beginning of the downturn to its end, and continued to rise through the summer of last year.

And yet it would be wrong to attribute Washington's success in creating jobs entirely to the public sector. Although federal spending rose, the recession forced state governments in Virginia, Maryland and the District of Columbia to cut back. And rising federal-government employment during the downturn was partly driven by efforts to save flailing private industry. The government added workers to oversee intervention in the financial-services and car industries, and financial-regulatory agencies have continued to add staff since. Washington has frequently grown stronger in the wake of economic calamity, often because of public demand for more market oversight.

Well away from federal government, Washington also has other advantages. Its suburbs support a rich array of high-tech and bioscience enterprises, many of which held up well during the downturn. The city's labour pool tends to be highly-skilled, and the impact of the recession was mostly felt by the lower-skilled. Based solely on the education levels of its adult population, the unemployment rate for the Washington area ought to be about 7%-well below the national average, and not far off its actual figure.

Republican budget-cutting may now take a toll. Washington's market for office space may cool as the federal government pares back its demand for space, and local retailers are grumpy about lost cost-of-living adjustments for federal workers. But the latest budget deal largely spared the region's economy. The federal government will continue to chip in for the city's rail transit system; but as part of the deal the District can no longer use its own money to pay for abortions. This will hurt the city's poorer residents, some of whom live in neighbourhoods with unemployment rates close to 25%.

Index | United States

Medicaid

In treatment

States grapple with big changes to government health care for the poor



It's going to cost you

MEDICAID is a behemoth. It accounts for about one-sixth of America's health-care spending. It is the single largest source of federal revenue to states. In 2009 it provided benefits to 63m people. Its costs will rise by 8% each year for the next decade, according to the programme's actuary. It is little wonder, then, that Washington, DC, is buzzing with plans to overhaul Medicaid. The real work, however, lies elsewhere.

Responsibility for Medicaid is shared by federal and state governments. The federal government matches state spending on the programme, providing more money for poorer areas. This help comes with requirements. States must agree to extend Medicaid to designated groups and pay for certain benefits.

Democratic and Republican leaders have competing plans to change Medicaid. Both, however, would place a greater burden on states. From 2014, Barack Obama's health reforms will require Medicaid to cover all adults with incomes at or below 133% of the federal poverty level. Washington will pay for most of these people. Nevertheless, the Congressional Budget Office (CBO) estimates that Medicaid's expansion will require the states to spend an additional $20 billion.

Paul Ryan, the Republican chairman of the House Budget Committee, has his own scheme. He would give states more freedom to administer Medicaid, but he would cap the federal government's contribution. States, the CBO estimates, would have to raise revenue or cut aggressively to offset the drop in federal spending. Mr Ryan's plan gives pleasure to both parties. According to Republicans, it would save money ($750 billion over ten years) and empower states (who Mr Ryan reckons are better managers than the nitwit feds). Democrats, meanwhile, can now declare that Republicans are punishing poor families and grandmothers. This cheerful duet looks set to drag on.

Such plans would be daunting at any time, says John Thomasian of the National Governors Association, but states are already overwhelmed by an immediate crisis: how to pay for Medicaid now. Medicaid gobbles up more state money than any programme except education. The federal stimulus gave them extra cash as Medicaid enrolment grew and revenues dwindled. But this will be gone by the end of June.

So state governments are scrambling to cut costs. Many want to place more Medicaid beneficiaries in managed care, which limits access to certain doctors and treatments. Some states want to test policies that will bring long-term savings- "medical homes", for example, supposedly provide cheaper, integrated care. In Arizona, fat patients and smokers may be charged an extra $50 if they fail to follow a strict medical regimen. But the most popular changes are those that slash spending immediately. "It doesn't help states to say they're going to save all this money in 2020," explains Diane Rowland of the Kaiser Family Foundation.

States have three main ways to cut costs, says Matt Salo of the National Association of Medicaid Directors. The first is to restrict eligibility, but Barack Obama's health reforms prohibit this. The second is to cut benefits-many states want to stop

covering spectacles and dental care. The third method is to cut payments to hospitals and doctors. State representatives in Texas want to slash rates by 10%, which may discourage doctors from accepting new Medicaid patients. California's effort to lower rates has been disastrous-a lawsuit aimed at forbidding the cuts has reached the Supreme Court. The legal problems, says Mr Salo, are making it harder for states to move forward. Washington's reforms may transform Medicaid in future, for better or worse. For now they only add to the states' uncertainty.

Index | United States

The New Orleans police

Guarding the guards

A perp walk for the enforcers

BY ANY measure, the New Orleans Police Department (NOPD) has been going through a rough patch. In December a federal jury returned guilty verdicts against three of five city policemen involved in the fatal shooting of a man, and the subsequent burning of his corpse, a few days after Hurricane Katrina struck, and then covering up the whole affair.

On April 13th a federal jury found against two officers who had been accused of beating another man so badly that they ruptured his spleen before dropping him off at the hospital and claiming he had fallen down. And this summer the Danziger Bridge incident, the most serious, is expected to go to trial. Six civilians were shot by police on or near that bridge in the days after Katrina, two of them fatally. They were unarmed and blameless, according to the five officers who have pleaded guilty to taking part in the shooting or helping to whitewash the police investigation of it. Six other cops will try to beat the rap.

Against that grim backdrop lawyers from the Justice Department recently unveiled a blistering report that seeks to diagnose everything that is wrong with the department. The report took ten months and is 157 pages long; federal authorities have described it as the broadest-ever investigation of a city police department. It is expected to form the basis of a set of reforms that will be imposed on New Orleans and enforced by a federal judge. The federal government has taken similar actions in the past against police departments in Los Angeles, Pittsburgh and Cincinnati.

Many of the report's findings were predictable. New Orleans police have a tendency to overuse force. And once force is used the department does a poor job of investigating whether it was justified. It has been at least six years since an internal investigation found that an officer had fired his gun unnecessarily, though violations are common. The report also says that the New Orleans police routinely conduct illegal stops and searches, especially of blacks and those whose first language is not English. Most of the criminal cases against the NOPD involve violence against blacks.

The federal report also investigates the police department's unusual and largely unregulated "paid-detail" system, which allows officers to provide security for businesses and events, in uniform, while not on duty. Roughly 70% of officers work such shifts to make up for their low pay. Investigators called the system "deeply flawed" and corrupting, with some officers more committed to their private work than their patrol duties.

To their credit, the leaders of both the department and the city (which invited the Justice Department in) have embraced the report. "The leadership in this city went to sleep," said Mitch Landrieu, the mayor. "We lowered our expectations." Ronal Serpas, the police chief, has made some reforms to the detail system since taking over the department in May, and he has dealt harshly with officers implicated in crimes.

But many crooked cops remain in the force. Hardly a month goes by without some officer being accused of a crime. A police captain has just been convicted of setting up a kickback scheme involving an inflated security operation. And in February a long-serving officer was convicted of picking up a woman suspected of prostitution, taking her to a warehouse and raping her.

Meanwhile, another recent Justice Department report noted that the city's murder rate is ten times the national average. A companion report recommended beefing up the NOPD's homicide squad by about 50%, while focusing less on prostitution, gambling and traffic duties. Mr Serpas has declared: "I am convinced we will be a world-class police department." He has his work cut out for him.

Car safety

Think before you speak

Distracted driving is the new drunk driving



THE driver who killed Jennifer Smith's mother in 2008 by hitting her car at a crossroads was sober and had never received a speeding ticket. But he was talking on his mobile phone. He was so engrossed that when the policeman later asked him what colour the traffic light had been, the driver said he had not even seen one.

Her bereavement prompted Ms Smith to start FocusDriven, a group modelled on Mothers Against Drunk Driving (MADD), which began in 1980. Indeed, Ms Smith is one of many people who consider "distracted driving" today the direct equivalent of drunk driving a generation ago. This is why April is "distracted driving awareness month" in America, with cops issuing more tickets and more publicity.

Through a combination of laws, education and cultural change, the struggle against drunk driving has come a long way since the 1970s. This is one reason why traffic fatalities have been falling in America-to some 32,800 deaths in 2010, the lowest since the Truman administration. Other reasons include safer cars (with anti-lock brakes, air bags and such) and stricter seat-belt and speeding enforcement.

The counter-trend has been increased distraction. Many things can compromise drivers' attention, from kids to food or the radio. But mobile phones pose the biggest risk, for research shows that these gadgets distract in a more pernicious way.

The human brain has to work harder to process language and communication with somebody who is not physically present. (Conversation with passengers is much less distracting, apparently because those passengers are also aware of the traffic situation and moderate their conversation.) A study by Carnegie Mellon University using brain imaging found that merely listening to somebody speak on the phone led to a 37% decrease in activity in the parietal lobe, where spatial tasks are processed. This suggests that hands-free use of mobile phones cannot help much. Such distractions, according to one study, make drivers more collision-prone than having a blood-alcohol level of .08%, the legal limit in America. It appears to raise the risk of an accident by four times. Texting multiplies the risk by several times again.

Officially, distraction accounted for 16% of traffic deaths in 2009 (up from 10% in 2005) and for 20% of injuries. The age group at greatest risk is, unsurprisingly, teenagers, though older drivers are not immune. But these statistics understate the truth, because few drivers after a crash admit to using mobiles, and police rarely demand phone records, says Joe Farrow, the head of California's Highway Patrol.

Laws vary widely. Japan in 1999 became the first large country to ban hand-held mobile-phone use while driving, and most rich countries and many poor ones have since followed. America is behind the trend. New York in 2001 became the first state with a similar law, and seven have since followed. Thirty states have banned texting while driving.

But these laws are fiendishly difficult to enforce, says Mr Farrow. For instance, his officers must directly observe a driver texting (as opposed to just looking down) for several seconds to pull him over, which is not easy on a freeway. That said, highly visible enforcement makes a huge difference. Syracuse, New York, and Hartford, Connecticut, last year tried an experiment in which cops issued dramatically more citations for two weeks and mobile-phone use fell sharply in both places.

"I don't think we'll see an outright ban in my lifetime in California," says Joe Simitian, a state senator who has written California's three laws against distracted driving. In a car-and-gadget culture, he reckons, the best hope is gradually to raise compliance over time, as with drunk driving. Technology might help-Google, for instance, is already testing cars that drive themselves and avoid accidents. In the meantime, says Ms Smith, driving distracted must become, like drunk driving, "totally uncool, socially unacceptable", especially among teenagers.

Index | United States

Lexington

Vicious or virtuous?

America's political system may have become too polarised to produce compromise



JUST how dysfunctional is politics in America? After last week's near-shutdown of the federal government, and with another scare to come when Congress votes on whether to raise the federal debt ceiling, this feels like a good time to ask. Unfortunately, it is absurdly easy to count the ways. Here is one fairly typical list, offered up at a recent event at the Brookings Institution by Dan Glickman, a former (Democratic) member of the House of Representatives and agriculture secretary under Bill Clinton.

First, money. Congressmen spend every waking minute raising the stuff. Their indebtedness to donors leads to paralysis, because most donors want either to retain the benefits they receive from Uncle Sam or press for more. Second, the self-reinforcing partisanship of the new media. Third, politicians are spending less time on Capitol Hill and more shoring up support back home. Reduced social contact makes it harder to build trust and strike compromises across party lines. This leads, fourth, to a reluctance to show leadership, if leading requires quarrelling with your own. Just look, says Mr Glickman, at how both parties treated the deficit-reduction proposals last year of the bipartisan Bowles-Simpson commission as a potato too hot to handle. Fifth, an atmosphere of total war encourages the parties to treat every battle, no matter how trivial, as Armageddon.

Mr Glickman's list is far from exhaustive. At the same meeting of the same think-tank, Bob Bennett, who served three terms as a (Republican) senator for Utah, offered a no less scathing critique. The flaws he enumerated ranged from television having killed debate (by making senators talk to the camera and not to each other) to the scandal of gerrymandering. Only a few dozen of the 435 House seats are genuinely in play between the parties. The real fight takes place inside the parties, in primaries where victory depends on moving to the extreme to woo the activists. Mr Bennett knows whereof he speaks about those: despite a strong conservative record, he was dumped by Utah's Republicans last year for having voted for the banking bail-out.

Naturally, even these grizzled veterans allow that some things have changed for the better. For all the money, corruption is less naked than it once was: Mr Bennett is proud that Senate offices are no longer designed with safes into which venal politicians used casually to stuff their visitors' personal cash contributions. Mr Glickman argues that although the media are more partisan they are also livelier-and that new social networks have enabled far more ordinary people to have a direct impact on politics. As for the comic opera that brought the government to the edge of a shutdown last week, there is always the reassuring thought that America's governing arrangements are dysfunctional by design. Arguably, the Founding Fathers favoured a system in which one foot stayed permanently on the accelerator and the other on the brake. Hasn't America got what they wanted?

Not quite. One big thing that has changed politics fundamentally is the extreme polarisation of the parties. The Brookings event was held in honour of Henry "Scoop" Jackson, a Democratic senator who died in 1983. In nearly half a century on the Hill he became famous for building cross-party coalitions and championing bipartisan legislation. But his is a dying breed. In 2010 Congress was more deeply split on partisan lines than at any time since the second world war, according to

Congressional Quarterly, a sister publication of *The Economist*, which has measured voting patterns on the Hill since 1945. And it is getting worse. So far this year, a record 80% of roll-call votes in the House have pitted a majority of Republicans against a majority of Democrats. On average, House Republicans have voted with their party's majority 91% of the time and Democrats 90% of the time. The picture is very similar in the Senate.

How can a government divided between two parties at loggerheads possibly take the painful decisions needed to tame America's deficit? At first glance, the events of the past fortnight look mildly encouraging. In spite of the brinkmanship, the parties endorsed a budget for 2011 without falling off the edge. Moreover, both sides now claim in their different ways to be serious about tackling the deficit and the entitlement spending that drives it. This is the topic that seemed too dangerous for either to address until the Republicans' Paul Ryan put his radical blueprint for 2012 and beyond on the table, thus forcing Barack Obama to counter this week with a plan of his own.

Here's hoping Winston was right

An optimist might infer that each party is at last shaming the other into taking the hard decisions they had previously ducked. The most striking aspect of this spectacle has been the behaviour of the president. After failing to prevent the Republicans lopping $38 billion off his own party's budget, Mr Obama promptly performed a jaw-dropping U-turn, heaping praise on, and taking credit for, the "largest annual spending cut in our history". You would think it was some other president who four months ago touted as a famous victory the spending increase he pushed through the lame-duck session of the previous Congress.

Mr Obama's inconsistency is no mystery. Posing as a conciliator seeking a sensible middle between the warring tribes on the Hill may help him win re-election in 2012. But for the present a posture is all it can be. Mr Ryan's plan would raise no taxes and, in effect, privatise Medicare. In other words, he has planted his party's flag so far to the right that it is hard to see how an agreement on the deficit could emerge from any Congress, let alone the most polarised one since the second world war. In the end, American politics may well rise to the needs of the moment, proving the truth of Winston Churchill's famous adage. But until then more comic opera, with even less amusing results, lies ahead.

Economist.com/blogs/lexington

Index | The Americas

Peru's presidential election

The masses blow a raspberry

Voters engineer an unappealing choice between two contrasting populists, Ollanta Humala (below left) and Keiko Fujimori (right)



IT IS hard to think of two politicians less attractive or qualified to run a country of 29m. But the outcome of a presidential election on April 10th means that Peruvians will have to choose in a run-off on June 5th between Ollanta Humala, a former army officer with no government experience backed by the far left, and Keiko Fujimori, whose father is a conservative ex-president serving a 25-year sentence for human-rights abuses and corruption.

Both Mr Humala, who won 32% of the vote, and Ms Fujimori (23.5%) embody a vein of populist authoritarianism running through Peru's history. They harvested a protest vote against the moderate democratic politicians who have governed the fastest-growing of Latin America's larger economies over the past decade, but who have failed to curb corruption and crime or do enough to improve social conditions.



The democratic centre-right vote added up to 44%, but was fatally split between a trio of candidates. Alejandro Toledo, the president in 2001-06, led the polls with 28% six weeks ago, but took just over half as much in the election. Pedro Pablo Kuczynski, who served as finance minister under Mr Toledo, stressed reform within the existing free-market economic regime and managed 18.5%, with his support concentrated among wealthier voters in and around Lima (see map). That was not bad for a former investment banker and IMF official, but not enough. Luis CastaÃ±eda, a former mayor of Lima, took 10%.

In the 2006 election Mr Humala won 31% of the vote in the first round, only to be narrowly beaten by Alan Garcia, who has governed as a conservative. Then Mr Humala was close to Venezuela's Hugo Chavez. He looks better placed this time: Ms Fujimori is a less skilful rival than Mr Garcia, and Mr Humala has moved towards the centre. His inspiration now is Brazil's former president, Luiz Inacio Lula da Silva, whose Workers' Party has offered him advisers. As Lula did before him, he has swapped his red T-shirt for business suits.

Mr Humala once talked of expropriating foreign mining and gas companies and creating new state enterprises. By the end of the campaign he sounded almost like Mr Kuczynski. He talked of legalising Peru's vast informal economy, negotiating higher taxes on mining and improving schools. But if Mr Humala is to allay suspicion about his plans among two-thirds of the electorate, he must repudiate his far-left written manifesto, drop talk of changing the constitution-the formula used by Mr Chavez to cling to power-and promise to appoint competent technocrats.

If Mr Humala arouses fears for the future, Ms Fujimori awakens fears of the past. Her father, Alberto Fujimori, defeated the Maoist terrorists of the Shining Path and implemented free-market reforms that laid the foundations of Peru's boom. But he used tanks to shut down Congress, rode roughshod over the constitution and presided over systematic corruption. His daughter has played down an earlier pledge to seek an amnesty for him. She promises continuity in economic policy mixed with social giveaways and illiberal talk of using the death penalty and anti-terrorist laws against crime. She may win the backing of many better-off Peruvians.

If Mr Humala eventually wins, in what remains a tight campaign, it will hardly amount to a triumphant leftist wave of the sort that propelled Bolivia's Evo Morales to power in 2006. His party will have only 46 seats in the 130-strong Congress. The constitution gives the Central Bank independence. Free-trade agreements with the United States, the European Union and China place limits on economic change. And, as Mr Humala's Brazilian advisers may point out, one secret of Lula's success was his decision to respect existing contracts and not reverse his predecessor's privatisations.

But the single-minded pursuit of foreign investment and economic growth that marked Mr Garcia's presidency now seems to be drawing to an end. Many Peruvian democrats will have nightmares in the coming weeks. A generation ago Peru's social fabric was rent apart by economic collapse and political violence. Around two-thirds of Peruvians still work in the informal economy. Although life has improved in the past decade, many are still susceptible to the appeals of would-be saviours-and there is more money to be grabbed to finance a bid for elected autocracy. The democrats will have to work hard to ensure that whoever wins on June 5th leaves promptly five years later.

Index | The Americas

Female labour participation in Chile

Taking leave of his senses

An extension of maternity leave is unlikely to get more women working

AS CHILE'S first conservative president since the return of democracy in 1990, Sebastian PiÃ±era has bent over backwards to reassure the country of his compassion and tolerance. The television and airline magnate's latest bid to be seen as moderate, however, may have got the better of his business sense. In March he sent a bill to Congress that would require the state to pay working mothers for up to seven months of maternity leave-more time than women get in France.

Mr PiÃ±era's concern for the plight of Chile's working women is justified. The country ranks 33rd of the OECD's 34 countries for female labour participation, ahead only of Turkey. And its current maternity-leave scheme, which offers six weeks of time off paid by the state before birth and 12 afterwards, is regressive: 52% of payments go to the richest fifth of women and just 5% to the poorest fifth.

In an effort to redress these failings, Mr PiÃ±era promised during his campaign to increase Chile's state-funded post-natal maternity leave by as much as 12 additional weeks. On taking office, he appointed a commission to advise him on the reform. Its report inconveniently discouraged the president from implementing such a large extension of the programme. It noted that the country's current scheme is already generous by Latin American standards, and that offering more time off was unlikely to help poorer mothers. Instead, it recommended extending the benefit to informal and short-term employees.

Extra maternity leave would probably not bring many more women into the workforce. Most local economists say that the biggest obstacle to female employment in Chile is the country's restrictive labour laws. One requires companies that employ 20 or more women to pay for child care. Little wonder that so many Chilean firms have precisely 19 female workers. Another rule prevents businesses from firing women for two years after they become pregnant-creating an incentive to fire them earlier, or not to hire women of childbearing age at all.

Mr PiÃ±era has taken some of these arguments to heart. His proposed reform grants maternity leave to some temporary workers, such as rural fruit-pickers, and reduces the two-year ban on firing pregnant women by three months. Yet he is unwilling to abandon his campaign promise. His bill would provide an additional 12 weeks of state-funded maternity leave at just under half the current subsidy level, and prohibit all but the richest 20% of mothers from working during that time. (They were exempted because matching their high salaries would have been prohibitively expensive.) Still, the new benefit would cost the government an estimated $150m-200m a year-a hefty burden given the costs of rebuilding after Chile's 2010 earthquake.

The bill will not be voted on for months while the president's congressional allies negotiate with their opponents-who want to make the law even more generous and water down its few attempts at cost control and labour-market liberalisation. Chileans may have elected a conservative president, but at least on some social issues, the centre-left still holds sway.

Index | The Americas

Cuba and the United States

Catch him if you can

A Texas court acquits an alleged right-wing Cuban terrorist



Castro's most wanted

ONE of the Cuban government's most legitimate criticisms of the United States involves its handling of Luis Posada Carriles. A Havana-born Venezuelan citizen, Mr Posada helped organise the 1961 Bay of Pigs invasion of Cuba. He later worked for the CIA to undermine Fidel Castro and assist Nicaragua's right-wing Contra guerrillas. In 1976 two of his employees blew up a Cuban aircraft, killing 73 people, including the country's national fencing team. Over 20 years later he was implicated in bombings of Havana hotels.

Mr Posada has largely evaded punishment for these crimes. He escaped from a Venezuelan prison while awaiting a trial for the aircraft attack, was recaptured and held for eight years without being convicted, and then escaped again. In 2000 Panama jailed him for plotting to kill Mr Castro during a summit. But Mireya Moscoso, Panama's president, pardoned him shortly before leaving office in 2004.

A year later Mr Posada sneaked into the United States and asked for asylum. When Venezuela sought his extradition, he withdrew his asylum request and was arrested. However, a judge refused to deport him on the grounds that he might be tortured in Venezuela-a claim many Cubans might find ironic, given the presence of Guantanamo Bay on their island.

Since then, Mr Posada has been in legal limbo. He was transferred from jail to house arrest in 2007 and indicted only in 2009. However, rather than prosecuting him for the bombings, the government charged him with lying about his part in them and about how he entered the United States, and for obstructing its investigations. His trial began in January in Texas.

Cuba and Venezuela have accused the United States of protecting Mr Posada by failing either to try him for terrorism or to extradite him. Yet prosecutors had to prove his role in the hotel bombings to show that he had lied. The evidence seemed strong. The government subpoenaed Ann Louise Bardach, who interviewed Mr Posada in 1998 for the *New York Times*. In a conversation she taped, he said he was the "boss" of the plot and that an Italian tourist who was killed was "in the wrong place at the wrong time". (He later recanted this confession.) Asked if he was sorry, he said he "slept like a baby". Prosecutors also unearthed a fax detailing payment for the attacks signed by "Solo", one of his aliases.

However, the defence cast doubt on the government's case by painting its witnesses as biased or unreliable. Moreover, the judge did not allow the fax as evidence. The jury debated for just three hours before acquitting Mr Posada on April 8th.

Even though Cuba and Venezuela had objected to the perjury charges at first, they were outraged by the verdict. Ricardo Alarcon, head of Cuba's parliament, called the trial a "stupid and shameful farce" because of limits on the evidence

presented to the jury. Venezuela's foreign ministry said it was "an emblematic case of the United States' double standard in the international fight against terrorism."

The easiest way for America to respond to such attacks would be to extradite Mr Posada-perhaps in a swap for Alan Gross, an American government subcontractor recently convicted of bringing communications devices into Cuba illegally. The only apparent risk this presents is that the 83-year-old Mr Posada might reveal still-secret chapters from the Americans' history of covert operations in Latin America.

Index | Asia

China's new rulers

Princelings and the goon state

The rise and rise of the princelings, the country's revolutionary aristocracy



"THERE are some sour and smelly literati these days who are utterly abominable," a retired military officer reportedly told a recent gathering in Beijing. "They attack Chairman Mao and practise de-Maoification. We must fight to repel this reactionary counter-current." At the time, two months ago, the colonel's crusty words might have had the whiff of a bygone era. Today, amid a heavy crackdown on dissent, they sound cruelly prescient.

One of the most prominent literati, Ai Weiwei, is among dozens of activists the security forces have rounded up recently. Mr Ai, an artist who is famous abroad, was detained in Beijing as he attempted to board a flight to Hong Kong on April 3rd. There has been no official confirmation since of his whereabouts. Officials say that he is being investigated for unspecified economic crimes, but the *Global Times*, a Beijing newspaper, warned that Mr Ai had been skirting close to the "red line" of the law with his "maverick" behaviour. In other words, he had apparently provoked the Communist Party once too often.

Since the late 1970s, when China began to turn its back on Maoist totalitarianism, the country has gone through several cycles of relative tolerance of dissent, followed by periods of repression. But the latest backlash, which was first felt late last year and intensified in late February, has raised eyebrows. It has involved more systematic police harassment of

foreign journalists than at any time since the early 1990s. More ominously, activists such as Mr Ai have often simply disappeared rather than being formally arrested.

It is an abnormally heavy-handed approach, one unprompted by any mass disturbances (recent anonymous calls on the internet for a Chinese "jasmine revolution" hardly count). This suggests that shifting forces within the Chinese leadership could well be playing a part. China is entering a period of heightened political uncertainty as it prepares for changes in many top positions in the Communist Party, government and army, beginning late next year. This is the first transfer of power after a decade of rapid social change. Within the state, new interest groups have emerged. These are now struggling to set the agenda for China's new rulers.

Particularly conspicuous are the "princelings". The term refers to the offspring of China's revolutionary founders and other high-ranking officials. Vice-President Xi Jinping, who looks set to take over as party chief next year and president in 2013, is one of them. Little is known about his policy preferences. Some princelings have been big beneficiaries of China's economic reforms, using their political connections and Western education to build lucrative business careers. Other princelings are critical of China's Dickensian capitalism and call for a return to socialist rectitude. Some straddle both camps. Prominent princelings in business include President Hu Jintao's son, Hu Haifeng, who headed a big provider of airport scanners; and Wen Yunsong, a financier who is the son of Wen Jiabao, the prime minister.

Cheng Li of the Brookings Institution in Washington, DC, argues that a shared need to protect their interests binds these princelings together, especially at a time of growing public resentment against nepotism. Since a Politburo reshuffle in 2007, princelings have occupied seven out of 25 seats, up from three in 2002.

The Mao-loving ex-colonel was talking to a group called the Beijing Friendship Association of the Sons and Daughters of Yan'an (where Mao Zedong was based before his takeover of China in 1949). No prizes for guessing that the group favours socialist rectitude. Its president is Hu Muying, a daughter of Mao's secretary, Hu Qiaomu. Mr Hu was a Politburo hardliner in the 1980s who died in 1992. Other princelings are association members, though it is unclear how many are current or expected holders of high office. In her speech to the gathering Ms Hu said she rejected the word "princelings", but declared: "We are the red descendants, the descendants of the revolution. So we have no choice but to be concerned about the fate of our party, state and people. We cannot turn our backs on the crisis the party faces."

The crisis, as her sort see it, is rampant corruption, a widening gap between rich and poor, and a collapse of faith in communist ideology. Details of Ms Hu's speech and the former colonel's were posted on several websites controlled by China's remaining Maoist hardliners. Journals put out by the hardliners were forced to close a decade ago because they were too blunt in their criticism of China's economic reforms. Yet the websites have kept up their tirades, including fierce denunciations of Ai Weiwei and other liberal intellectuals long before the recent arrests.

The Maoists' lingering influence has been evident for the past couple of years in the south-western (and Scotland-sized) municipality of Chongqing. There, one of the country's most powerful princelings, Bo Xilai, Chongqing's party secretary, has been waging a remarkable campaign to revive Maoist culture. It includes getting people to sing Mao-era "red songs" and sending text messages with reams of Mao quotations. A local television channel has even started airing "revolutionary programming" at prime time. Last year Chongqing's fawning media ascribed a woman's recovery from severe depression to her singing Mao-vintage songs.

The campaign has drawn plenty of attention. Mr Bo is a Politburo member who is thought to be a strong contender for elevation next year to its standing committee, the party's supreme body. He has become a darling of the Maoists (their websites say that the same colonel singled out Mr Bo for praise, to applause from the audience). For a long time it had been thought that Mr Bo and Mr Xi did not get on. But in December Mr Xi visited Chongqing and said its red revival had "deeply entered people's hearts". It deserved all its praise.

Few people-certainly not Mr Bo or other contenders for power-are calling for a return to Maoist despotism and an end to market economics. What worries many liberals, however, is that they share Mao's high-handed approach to the law. In Chongqing a sweeping campaign against the city's mafia-like gangs and their official protectors has won Mr Bo many plaudits in the state-controlled press. But the jailing of a defence lawyer for one of the mobsters, for allegedly trying to persuade the accused to give false testimony, has led many to worry that Chongqing's courts will do anything to prevent

lawyers from challenging the prosecution. He Weifang, a prominent legal expert at Peking University, wrote this week that recent events in Chongqing "threatened the basic principles of a society under the rule of law".

The manner of the recent crackdown could be a sign that Mr Bo's approach (which includes dollops of spending on housing for the poor) is gaining favour in Beijing. It is also a sign of the increased influence of the domestic security apparatus since 2008, when China pulled out all the stops to stop unrest marring the Olympic games in Beijing. The power of Zhou Yongkang, the member of the Politburo's standing committee in charge of security, is widely thought to have grown along with a rapid increase in government spending on his portfolio.

More liberal thinking has not been entirely suppressed. The party chief of Guangdong province in the south, Wang Yang, who is another (non-princeling) contender for the Politburo's standing committee, is widely seen as a bit more open-minded. Shenzhen, a special economic zone in Guangdong, has been experimenting in giving a freer rein to NGOs. The province's newspapers are among the country's most spirited (for which they are bitterly attacked by leftist websites). But Mr Wang has a cautious streak, too. The official media reported this week that 80,000 "potentially unstable people" had been evicted from Shenzhen in preparation for a sporting event this summer.

One of the most powerful criticisms of the clampdown came on April 8th from Mao Yushi, a notable economist. In a blog posting at *Caixin Media*, an outspoken publishing group, Mr Mao accused leaders of making a mistake by neglecting political reform in their plans for China's development in the next five years. Spending ever greater sums on maintaining stability, he said, just made citizens more hostile. Determined not to allow any disruption to next year's high politics, Chinese leaders are willing to take that risk.

Index | Asia

Sri Lanka and war crimes

Keep quiet and carry on

A crackdown precedes a new report on the end of the civil war



SRI LANKA'S government has got its retaliation in first. On April 12th a panel of experts delivered a report to the UN secretary-general, Ban Ki-moon, assessing whether war crimes were committed when the nation's army bloodily won a long-running civil war against Tamil Tiger rebels early in 2009. The report has not yet been made public, but the government is furious that an independent inquiry took place at all. The report, it says, is "fundamentally flawed" and biased.

In recent weeks Sri Lanka's rulers have vented their anger, most obviously by cracking down at home, intimidating those they blame for spurring the launch of the UN inquiry in the first place. At the sharp end are Western-funded education and advocacy groups, notably those keen on post-war reconciliation or those that point out flaws in the government of President Mahinda Rajapaksa. Facing the most intense scrutiny are groups which have complained about repression, a muzzled press and a lack of civil liberties.

Top of the list is the National Peace Council, which pushed for a negotiated rather than a violent end to the war. Last month criminal investigators summoned its director, Jehan Perera, demanding details of the group's funding and operations. Before that, a smear campaign in the press suggested the council takes orders from foreign donors. No specific crime has been alleged, making it harder for the council to clear its name.

Under surveillance, too, is the local branch of Transparency International, an anti-corruption watchdog. In October, after it launched a project to monitor abuse of public resources, investigators called in its accountant to quiz him over "suspicious transactions". The inquiry was dropped, but the pro-government press has continued to vilify the group.

Most exposed of all are bodies which, as the war reached its climax, spoke up for civilians caught in the crossfire. Fierce army onslaughts finished off the brutal Tamil Tigers, but thousands of civilians were killed, injured or displaced in the process. Human-rights groups in the West backed the activists' campaign. The government strongly denies any abuses and instead attacks the campaigners, saying they have involved foreigners in an internal affair. Now it accuses the NGOs of raking in funds without explaining how they are used, though the groups have offered to show their audited accounts.

Several factors help explain the timing of all this. Some in Mr Rajapaksa's hawkish government seem convinced that his opponents are conspiring with the West or, worse, with the active and educated Tamil diaspora, to discredit him. By spreading the idea that "fifth columnists" fed harmful information to foreign experts, the government hopes to discredit the UN report.

If, in turn, other NGO types are worried by a crackdown, they might become less willing to snipe about other problems in Sri Lanka, such as pervasive nepotism. Journalists, too, might usefully be scared. On March 31st police arrested the editor of a popular pro-opposition website. In Orwellian style, he was accused by the state-run media of being behind a January arson attack that destroyed his own office and equipment. Supposedly, this was to bring the government into disrepute, by getting officials blamed. But scariest of all, one of the website's reporters, Prageeth Eknaligoda, has now been missing for more than a year. It can be dangerous to speak out in Sri Lanka.

Index | Asia

India's political activists

The fast and the furious

A radical's idea for fighting graft stirs a debate on Indian democracy


A victory toast

"PEOPLE are convulsing. This is good," says a man with a trim, grey beard. Nearby, in the shade of a neem tree, protesters with banners and flags listen as a speaker inveighs against corruption. In a tent, a former assemblyman crouches on a platform and calls for criminals to be barred from public office. An assistant explains that he is only on "indicative" hunger strike today, "but his fast until death will start on April 14th."

Jantar Mantar, a street in the middle of Delhi, is a favourite spot for activists: Tibetans praying for political freedom, students marching to have a headmaster sacked, minor politicians desperate for attention. Few achieve much. But one of them, Anna Hazare, an ageing rural activist with a hint of Gandhi about him, has just scored a tremendous victory.

He had vowed to fast to death unless the prime minister, Manmohan Singh, agreed to push through parliament a long-stalled plan for a Lokpal, a powerful anti-corruption ombudsman. His previous hunger strikes were ignored. Yet this time, to his own surprise, Mr Hazare barely had time to get hungry. On April 9th, four days in, the government conceded everything, agreeing that activists should supply the chairman and half the members of a committee that will draft a new law, which will in theory produce the Lokpal within just a few months.

The government was wise to capitulate. Mr Hazare had caught the public mood. A Facebook campaign sent celebrities, carpetbaggers and young urbanites eager to be jasmine revolutionaries all flocking to Jantar Mantar. Some fasted beside Mr Hazare. Others marched with candles and placards. Support for Mr Singh's government promised to waste away even quicker than Mr Hazare.

The fight is not yet over, though. Columnists have lined up to snipe at the "Hazare phenomenon", hinting that an extra-parliamentary movement is undemocratic by definition. Urban activists, a tiny minority, must not force the hands of politicians picked by hundreds of millions, they intone. Mr Hazare has also said some foolish things: for instance, that ordinary folk are too stupid to understand the value of their vote, giving it away for cash or a new sari. He has also lost some shine after calling for crooked officials to be executed, and praising Gujarat's hardline Hindu nationalist chief minister, Narendra Modi.

Now the two sides must reconcile their ideas for the anti-corruption body. A longstanding government draft bill for a Lokpal wastes the paper it is written on. It would set up another toothless body, unable to investigate elected officials and under the thumb of public figures who have let corruption flourish for decades. The activists' ideas are fresher: Nobel laureates, judges, the electoral commission and other notables would pick Lokpal members. It would get powers to start investigations, even of the prime minister, and to suspend elected officials, even cabinet ministers, suspected of corruption.

The disagreement is about power. The activists say corruption will be curbed only when independent officials of high integrity are appointed to wield an effective stick over elected ones. That is unconstitutional, the politicians retort: in a

democracy it must be voters, not Nobel laureates, who decide. The politicians are unlikely to back down, especially once a series of state elections is out of the way, in May. Assuming he has the stomach for it, Mr Hazare may well be back in Jantar Mantar this summer.

Japan's post-tsunami politics

Flailing

Political co-operation, hard before the earthquake and tsunami, has got harder



AS JAPAN copes with its worst crisis since the second world war, the prime minister, Naoto Kan, is calling for a new politics. In particular, he wants collaboration with opposition parties mostly bent on ousting him. "Many ways of doing things in this country have come to the end of the road," he said on April 11th. "To rebuild this country, we need a new mindset. I hope for-and expect-a new direction."

He seems unlikely to get it. The quake and tsunami that devastated north-eastern Japan, and the nuclear disaster that followed, have disrupted the economy, with power shortages and stricken factories. Ordinary Japanese have cut back on inessential spending, in a mood of sacrificial restraint. Much has changed. Yet one constant remains: petty political bickering.

As the government has attempted to deal with the mess, the opposition Liberal Democratic Party (LDP) has picked on minor gaffes to justify exaggerated displays of outrage. Mr Kan's offer to the LDP's leader, Sadakazu Tanigaki, to form a "grand coalition" with his Democratic Party of Japan (DPJ) was rebuffed. The opposition thinks Mr Kan is flailing and his prime ministership, which was in trouble well before the earthquake, is in danger.

In opinion polls, Mr Kan's personal support has increased slightly since then, but around two-thirds of voters are disappointed with the government's handling of the crisis, particularly at the Fukushima nuclear plant. On April 12th the nuclear accident there was upgraded to level seven, the highest rating on an international scale of severity. That places it

on a par with the Chernobyl disaster 25 years ago this month (though the radiation released at Fukushima is only a tenth of Chernobyl's, and nobody has died from it yet).

On April 10th the DPJ's troubles took their toll in regional and local elections. The party lost all three of its races for prefectural governorships to the LDP. It failed to gain a plurality in any of 41 prefectural and municipal assemblies that were up for grabs. The drubbing has emboldened LDP politicians to resist more collaboration. As ever, they aim to oust Mr Kan and precipitate an early general election.

A semblance of political co-operation may last only until a second round of local elections on April 24th. It leaves just enough time to pass the first of many proposed disaster-relief bills. Some Â¥4 trillion (around $48 billion) will go towards rebuilding, as well as helping tsunami victims and farmers and fishermen whose businesses have been hurt.



Later bills will be the source of fresh squabbles. The opposition will urge the DPJ to abandon pledges to introduce a child-support allowance and eliminate toll-road fees. Although the DPJ used these campaign pledges in 2009 to help defeat the LDP after a half-century in power, they are only mildly popular now. People know they will push Japan ever deeper into debt.

Complicating Mr Kan's position is the make-up of his own party. The DPJ is stuffed with backbenchers loyal to Ichiro Ozawa, an old-timer who resigned from the party leadership because of a fund-raising scandal but who still undermines Mr Kan. The prime minister has to cut his cloth to suit Mr Ozawa's gang.

The LDP is hardly in better shape. Few people believe it would have handled the many-headed catastrophe any more adroitly. And they know that the LDP's long dominance in some ways prepared the way for the crisis. For instance, weak regulation of the nuclear-power industry allowed old, ill-supervised reactors such as those at the Fukushima plant to remain in service.

The party is beset by internal conflict. The dinosaurs see little need to revitalise the party's appeal or methods. Indeed, post-tsunami reconstruction, they think, is a way to dole out public-works contracts, just as in the old days. Younger members think this is why politicians and voters who over the years grew disenchanted with the LDP are not returning to the fold. According to a recent poll in the *Yomiuri Shimbun* newspaper, half of Japan's public supports neither party.

Index | Asia

Censorship in South Korea

Game over

A liberal, free-market democracy has some curious rules and regulations

OVER 700,000 South Korean children own smartphones, such as the Apple iPhone or a local rival by Samsung Electronics called the Galaxy S. Many use them so much for mobile online gaming that some 50 parental associations

have called for an imminent night-time curfew for under-16s playing online computer games to be extended to mobile phones.

Concern over computer games is nothing new. Claims that marathon gaming sessions in South Korea's "PC-bang" internet cafes have led to violence, including deaths, have prompted much soul-searching. All the same, the state seems too keen to use heavy-handed regulation. Its Game Rating Board (GRB), with the legal power to ban any game, now risks obstructing the development of an entire industry, one of the country's most vibrant.

Graphic games such as Grand Theft Auto III are already off-limits to Korean gamers. But the chief problem is the GRB's trouble keeping up with the sheer number of new mobile games being released on the iPhone and the rival Android platform, which Samsung uses. The board insists on a long approval process for even the most innocuous games. Apple and Google, which developed Android, are avoiding trouble by simply not selling any games to Korean customers.

Yet many "indie" games developers in South Korea desperately want to reach customers. With talented programmers and a ready-made market of smartphone-owning game obsessives, this is a natural growth industry. The government pays lip service to the idea of encouraging entrepreneurship among the young. Yet the GRB, says Kim Jin-sung at Pig-Min, a games developer, is "the arch-enemy of the Korean gaming community".

This is all part of a bigger problem: technology-related censorship. In 2009 an online "economic prophet" who called himself Minerva was prosecuted for making gloomy predictions about the South Korean economy and casting aspersions on policymakers. The 30-year-old was later acquitted. The only charge that stuck was the state's heavy-handedness.

Unusually in a democracy, a "real-name" system is now in effect for those posting on popular online forums: any participant signing up to websites must use their national identity number. So would-be Minervas are now easily traced. The spread of false information carries a maximum punishment of five years' imprisonment and a hefty fine.

What is more, since 2008 a supposedly independent Korea Communications Standards Commission has had the remit to promote a "sound and friendly communications environment". Critics argue that the commission serves as the government's de facto internet censorship body. It is supposed merely to "advise" portals to remove articles believed to contain falsehoods, obscenity or statements in favour of North Korea that infringe the National Security Act. In fact it may issue administrative orders backed up by law, forcing content to be deleted. Unsurprisingly, its "advice" tends to be followed.

Chang Ha-joon of Cambridge University, whose free-trade critique, "Bad Samaritans", is on a list of books the defence ministry has banned troops from reading, argues that such efforts are counterproductive. "This is not the 1980s, when you could just cut a few telephone lines," he says. Blocking free speech in one place would simply "start a bushfire" somewhere else.

Much of the desire to control the flow of information and ideas can be traced back to longstanding fears over the spread of North Korean propaganda, which remains illegal. The administration of President Lee Myung-bak has additional suspicions about the power of IT thanks to massive, internet-driven protests against imports of American beef that brought Seoul to a standstill in 2008. Yet South Korea's mild paranoia about controlling information harms its reputation as a liberal democracy and undermines its potential as a creative powerhouse.

Index | Asia

Australian politics

A Rudd return?

A former prime minister sets a cat among the pigeons



EARLIER this month Kevin Rudd, Australia's foreign minister, found himself staying in the same Brisbane hotel as Julia Gillard, who deposed him as prime minister just ten months ago. The Stamford Plaza, on the Brisbane river, had just been celebrating its reopening after repairs to damage costing A$20m ($21m) caused by the floods that devastated Queensland in January. If the hotel had hoped for a joint picture of its two political guests to kick the party along, it was disappointed. Such is the lingering tension between Mr Rudd and Ms Gillard that they strenuously avoided running into each other.

Mr Rudd was visiting his home state to sell the message that Queensland's resource-rich economy was humming again after the floods. Ms Gillard was in Brisbane to meet victims who are still fighting with insurance companies to settle claims. Hovering like a political equivalent of Yasi, the cyclone that ripped across northern Queensland soon after the floods, was a television appearance by Mr Rudd a couple of days before. In it, he revealed much about the Labor government's divisions over the issue that led to his downfall: climate change, the "third rail" of Australian politics.

Mr Rudd got Labor into office in 2007 on a pledge that Australia would do its bit to tackle climate change. As prime minister, he later dropped the pledge. The decision triggered Ms Gillard's leadership coup. After months of silence, Mr Rudd used Q&A, an Australian Broadcasting Corporation programme, to admit that his decision was "a wrong call for which I uniquely am responsible". But he then talked of "massive conflict" among ministers. And he intimated that Ms Gillard might have been among those who had urged him to make that call. Exploring the decision's entrails, he said, "may not be a pretty story."

Mr Rudd's cabinet revelations have angered colleagues and made life harder for the prime minister. Partly to placate her parliamentary allies, the Greens, Ms Gillard wants legislation passed this year imposing a carbon tax. On April 13th the government announced that half of the revenues from the tax would go back to households that faced higher energy costs. Mr Rudd's abandoned scheme offered something similar. He now says that climate action by Australia is critical. In Cairns, in northern Queensland, he warned that the Great Barrier Reef could be an early casualty of inaction.

In Queensland Mr Rudd enjoys local-hero status. The state media were interested more in a question that his television performance raised: whether he wants to have his old job back. His denials left many unconvinced. A national opinion poll on April 5th showed the government's approval at just 32%. Another found that 39% thought Mr Rudd should be Labor leader, five points more than those who supported Ms Gillard. Mr Rudd says he is confident the government can survive the turbulence that climate policy has put it through. Whether it could survive the storms of a Rudd comeback is another matter.

Index | Asia

The finitude of forests

A scheme to save the world's rainforests still seems too good to be true



AS THE heavens open, the canopy offers scant protection from the downpour, so the orang-utans tear leaves off the trees to make pathetic little umbrellas to hold over their heads. It is an endearingly human gesture but, as a means of keeping dry, almost entirely futile. And it is not just the rain that makes these creatures seem so helpless. The relentless destruction of their tropical-forest habitat has endangered their entire species.

In Borneo, in the Indonesian province of Central Kalimantan, they can relax in a camp devoted to their welfare on the edge of the Tanjung Puting national park. But the park-415,000 hectares of protected tropical heath forest and peat forest-is surrounded by oil-palm plantations. These orang-utans are refugees from forests cleared to make way for the plantations. Much as people like the creatures, and devotedly as conservationists work, the park is not enough to stem their remorseless decline. There is too much money in palm oil, as well as timber, coal, gold, zircon and the forest's other vegetable and mineral riches.

Yet prospects for the orang-utans have recently looked up. Climate-change fears have drawn attention to the work forests do to sustain not just wildlife but the planet itself. The outlines of a scheme under which developing countries would be paid not to cut down trees has been agreed. Indonesia, for example, chafes at its reputation as the world's third-biggest emitter of carbon (a ranking it disputes). It has promised to cut its emissions by 26% by 2020 or, if promised foreign cash actually materialises, by 41%. It will achieve this in large measure by reducing deforestation.

However, turning the scheme-known as "Reducing Emissions from Deforestation and Forest Degradation", or REDD-into actual conservation is not proving easy, either in Indonesia as a whole or in Tanjung Puting in particular. Next to the park is a stretch of peat-swamp forest, mostly degraded but rich in carbon. A Hong Kong firm called infiniteEARTH has earmarked this for a REDD project called Rimba Raya ("infinite forest"). Birute Galdikas, a renowned primatologist who has been studying orang-utans in Tanjung Puting since 1971, is "thrilled" by the idea. Rescued orang-utans, of whom more than 300 are in her care centre in the park, could be freed without danger to the wild population.

Rimba Raya seems to offer many other benefits. Trees would be replanted or conserved (Borneo's forest has more tree species per hectare than anywhere else); the forest would regenerate; some 10,000 people would benefit from "community

development" projects such as one to increase fishing yields. And the earth would be spared a huge amount of emitted carbon: by one calculation, as much as 75m tonnes over the next 30 years. The project's investors, including Gazprom, a Russian energy giant that has paid in advance for some carbon credits, think it will be lucrative. And it has passed most of a tough certification process.

Yet Ms Galdikas is worried that the project may never happen. Three years on, the final land-use decree has yet to appear. The problem is one that will dog REDD. To win certification, Rimba Raya has to show that the forest is under genuine threat: no point in giving carbon credits for conserving trees and peatland that were not in danger anyway. In Rimba Raya's case, the threat is real enough. The area is subject to various overlapping concessions, including preliminary licences for conversion to palm-oil plantations. The holders of those licences, who have already invested in the concessions, are naturally reluctant to give them up.

According to those following the project, this is a political battle in which the forces on the other side have considerable muscle. It also reflects a broader struggle over REDD in Indonesia being fought at the national level. Last May Indonesia's president, Susilo Bambang Yudhoyono, announced a two-year moratorium on commercial deforestation starting on January 1st this year. In return, Norway committed $1 billion for REDD payments.

By coincidence, Central Kalimantan has been picked as the pilot province for the national REDD scheme-against fierce competition from other places scenting the cash on offer. Norway has already disbursed $30m. It has helped to produce a suitcase-sized book of 280 maps that is buckling the desk in the Jakarta office of Kuntoro Mangkusubroto, head of Mr Yudhoyono's "delivery unit", who is entrusted with implementing REDD. The maps are to be attached to a long-overdue presidential decree meant to formalise the moratorium. But both maps and decree are controversial. The maps show, in dark green, Indonesia's virgin jungle and, in a lighter shade, the secondary forest which, in many places, surrounds it. In Mr Kuntoro's favoured draft of the decree, the moratorium would cover all the green splodges. A rival draft, by the forestry ministry, would cover just virgin forest-much of which, activists say, is in theory protected anyway.

Money still grows on trees

Both the Norwegians and Mr Kuntoro play down the importance of the delay in issuing the decree, and indeed of the moratorium itself. They argue that it matters most as a means to an end: a radical overhaul of Indonesia's land-use and forest-management systems. These have long been riddled with corruption. Under the 32-year dictatorship of Suharto, which ended in 1998, forest concessions became weapons in the armoury of crony capitalism. Such traditions are hard to break.

Much hope is invested in Mr Kuntoro himself, perhaps Indonesia's most respected civil servant. But success will depend on the political will of the president. Erik Solheim, Norway's minister in charge of the environment and development, points to the encouraging example of Brazil, which has cut deforestation rates by 70% in five years. Indonesia, he concedes, "is harder". Ms Galdikas knows what he means. "They all talk a wonderful talk," she says, "but the forest keeps getting destroyed."

Economist.com/blogs/banyan

Index | Middle East & Africa

Cote d'Ivoire's upheaval

From potentate to prisoner

Laurent Gbagbo, the former president, is at last taken out of action-but will his country right itself?



AFTER more than four months of devastating factional violence, Laurent Gbagbo, Cote d'Ivoire's former president, has at last surrendered. He was flushed out of a bunker in the presidential palace in Abidjan, the country's main city, by a combination of French firepower and the determination of erstwhile rebel troops now backing Alassane Ouattara, the internationally recognised new president of the former French colony.

If it was a victory for democracy, it was also one for force over mediation and diplomacy. Mr Gbagbo, who seized power from another unelected leader in 2000, had ruled the once-thriving West African cocoa producer with an iron hand. For ten years, he managed to avoid putting his popularity to a democratic test. When an election deemed largely free and fair by international observers, was eventually held at the end of last year, he lost the run-off to his rival, Mr Ouattara, by a clear 54% to 46% but he refused to accept the result and hunkered down.

The Economic Community of West African States, of which Cote d'Ivoire is a member, the African Union and the UN all put increasing pressure on him to accept Mr Ouattara's victory. America and the EU imposed a trade embargo, forcing the closure of the country's two main ports. But Mr Gbagbo still hung on.

Late last month, holed up in the Hotel du Golf in Abidjan where he had been under siege since the election by forces loyal to Mr Gbagbo, Mr Ouattara decided it was time to resort to his own forces. The former rebel army, now calling themselves the Republican Forces, swept down from their base in the north, arriving in Abidjan on March 31st after meeting little resistance on the way. It seemed it would be a matter of days before Mr Gbagbo would be forced to surrender.

But he continued to cling on-despite the destruction of his heavy artillery and ammunition dumps, the defection of most of his troops and the surrender on April 5th of his generals. It took another six days of fierce fighting and appalling bloodshed before he was captured.

In all this, France has played a key, and often contested, role. Without the aid of France's helicopter gunships (Mr Gbagbo had no fighter aircraft) and 1,750 French elite troops, Mr Ouattara would probably have been doomed. France insists that everything it did was performed at the express request of, and in conjunction with, the UN and its 9,000 peacekeeping troops stationed in the country.

The actual arrest of Mr Gbagbo was carried out by the Republican Forces alone, it says. Perhaps, but with some crucial help from their French friends. It may not help that Mr Ouattara, a former Ivorian prime minister and deputy director of the IMF, has been a close friend of the French president, Nicolas Sarkozy, for the past 20 years. Mr Gbagbo's people accuse France of orchestrating a coup d'etat in a bid to regain control of its former colony.

None of this augurs well for Cote d'Ivoire's future. For a decade or more the country has been racked by factional and ethnic violence. Atrocities have been committed by both sides, the most recent by pro-Ouattara forces in the country's west. The new president has called for an investigation, along with the creation of a South African-style peace and reconciliation commission.

But at the same time he is insisting that Mr Gbagbo be put on trial promptly before an Ivorian court. There is already worried talk of "victor's justice". The International Criminal Court has hinted that it might begin investigations into alleged war crimes and crimes against humanity, but it cannot act if the country involved has shown it is willing and able to do so itself.

Almost normal again

Meanwhile, battered Abidjan is slowly starting to come back to life after nearly two weeks of virtual shutdown and a growing humanitarian crisis. Republican Forces are patrolling the city picking up any suspected pro-Gbagbo militiamen and searching for weapons. UN and French troops are attempting to restore a semblance of law and order.

People are venturing on to the recently deserted streets in search of food and water. Shops and markets are reopening. The first ship for months is expected to dock in the next few days. But the task of restoring national unity and economic prosperity to this divided and war-torn country is immense and likely to take a very long time. If one battle is over for Mr Ouattara, a much bigger one is only just beginning.

Index | Middle East & Africa

Nigerian elections

Ballots and bullets

Political violence reaches new heights

RESULTS in Nigerian elections come in two separate columns. One records the votes cast at polling stations; the other the number of people killed around the time of the election. Violence is an integral part of Nigerian politics. That is still sadly true, even though reforms have made this year's elections much cleaner and fairer than previous ones.

Estimates of killings range from 100 to 200, excluding victims of violent conflicts that were fanned by politicians but not specifically tied to the elections. On April 8th, a day before the parliamentary poll, a bomb exploded at an electoral office near the capital, Abuja, and thugs attacked a police post storing voting materials in the north-east, killing at least 12 people. The news barely raised eyebrows in Nigeria, where voters are used to spikes in violence at election time. Wole Soyinka, winner of the Nobel prize for literature, calls it "the Nigerian way of dying".

Election violence comes in different forms. A handful of candidates have been killed this year in blatant attempts by incumbents to remove powerful challengers. In a few cases the police have launched desultory investigations but little more, perhaps because its chiefs are part of the political elite that stands to gain from the violence. Security forces are poorly trained and lack resources.

Less prominent but more common are random attacks to frighten voters, either into voting a certain way or into staying away from polling stations altogether. Politicians have been known to hire gangs and arm them to disrupt rivals' campaign events. Some have thrown hand grenades during public speeches. Elsewhere they have snatched ballot boxes. In one case, a man dressed as a chicken apparently distracted bystanders while his accomplices made off with tally sheets.

Electoral competition in Nigeria is fierce, as those holding political office have easy and unregulated access to vast pots of cash. Africa's largest oil producer earns $30 billion-40 billion a year from oil, much of it disbursed without strict

accounting. That has attracted a lot of crooks into politics. So-called godfathers sponsor aspiring politicians in return for promised shares of government money. Some use weapons to ensure that their candidates win.

Violence outside election periods is also driven by tussles over state resources. Having left behind years of military rule, Nigerian society is no longer riven with fear. But suspicion remains high. Deep cleavages-between Christians in the south and Muslims in the north but also among ethnic groups-fuel distrust and poison the political system. To win their share of resources, many groups believe they have to fight.

The intensity of various regional conflicts rises and falls with the level of government funds available. The Niger Delta, where militants have long demanded a greater share of the revenues from local oil production, has been relatively quiet since the government pumped millions into an amnesty programme. The militants reciprocated by declaring a ceasefire during the election. The interior is now the main flashpoint. Boko Haram, a Muslim extremist group operating in the north-east, is the single biggest threat. Its members spout Islamist cant-opposing, for example, the view that rain comes from evaporated water-but they can be bought off.

In the meantime, with more elections on the way-a presidential vote on April 16th and governors' races on April 26th-a new wave of violence is likely. Supporters of losing candidates have threatened to bypass the courts, which many see as biased, and take to the streets.

Results from the parliamentary election have already stirred up anger. Opposition groups are calling for some races to be rerun after reports of rigging, even though on the whole the election has been remarkably honest. The ruling People's Democratic Party lost seats in both parliamentary chambers but not its majority. Yet if it looks as if it might lose the presidency, things could turn nastier.

Index | Middle East & Africa

Justice in Kenya

The odd couple

Two old political enemies form a surprising alliance



Playing the wrong tune

IT WAS hard to tell who the accused were. Surely not the two gleeful men, arms upraised, surrounded by cheering crowds in an open-air prayer meeting in Nairobi's city centre on April 11th? What did they have to whoop about?

William Ruto, a suspended minister of higher education, and Uhuru Kenyatta, the finance minister and son of Kenya's founding president, Jomo Kenyatta, were treated like heroes when they returned from the International Criminal Court (ICC) in The Hague, where they had attended preliminary hearings. Both men are accused of orchestrating mass violence after the disputed election in 2007 that the ICC says killed 1,500 Kenyans and displaced 500,000. They are likely to be charged with crimes against humanity.

It is not clear when the court will try the two men, plus four other Kenyans, including Francis Muthaura, head of the civil service, and Hussein Ali, a former head of the police. But the case has already had an impact on Kenyan politics. The two men were on opposite sides four years ago but are now allies. Both still have legions of supporters. They might even form a joint party to contest next year's election.

The present government of national unity was put together by Kofi Annan, a former UN secretary-general, after the election. The incumbent president, Mwai Kibaki, from the Kikuyu ethnic group, stayed on. The opposition leader, Raila Odinga, a Luo, became prime minister. But that arrangement is now strained.

This week Mr Ruto was cleared of corruption in a separate local case that had got him suspended from the cabinet. He may now return and stir up trouble once again, especially for Mr Odinga.

There are worries that the ICC proceedings could distract the elite at just the moment when it needs unity to implement an ambitious new constitution. This mandates reforms to the police and judiciary among many others. Still, 61% of Kenyans want the ICC to go ahead with its case, according to one recent poll.

Kenya is east Africa's most dynamic country but it remains a brittle construction left behind by British colonial rulers. Finance and security are dominated by Kikuyu, who claim to be holding the place together. Mr Odinga's Luo supporters feel disenfranchised. Not enough money has flowed to their homeland in western Kenya to satisfy them. If Mr Odinga is frozen out of the presidency in next year's election, more conflict is possible.

Libya v Libya

The colonel's fake diplomacy

Muammar Qaddafi half-heartedly offers a ceasefire and keeps on fighting



Another last hurrah

MIGHT statecraft work where military action has failed to break the Libyan deadlock? Hopes fluttered briefly as African Union delegates traversed Libya's warring halves in an attempt at reconciliation, even as a group of European, American and Arab ministers convened for a second meeting on Libya, in Qatar on April 13th. Still more ministerial talks took place in Cairo a day later. But despite the fevered shuttling these missions appear unlikely to bear fruit.

Without a prospect of reaffirming his role, Libya's embattled leader, Colonel Muammar Qaddafi, seems inclined to reject any deal. Without his departure, rebels controlling the country's eastern half will turn their backs. And even if an agreement materialises, neither will trust the other. In a repeat of earlier episodes, African statesmen found themselves insisting that the colonel had accepted a ceasefire even as his forces continued to pound Misrata, a rebel-held city in western Libya that has withstood a two-month siege.

The military front remains deadlocked. Neither side has overcome the logistical difficulties presented by the barren 400-kilometre stretch that separates populated patches along Libya's eastern and western coastal plains. Colonel Qaddafi's better equipped forces hold the advantage on the ground, but NATO air strikes are degrading his materiel and stopping any breakthrough to Ajdabiya, the gateway to the East. And although the strikes have whittled away his armour, with NATO claiming to have knocked out 16 tanks on April 12th alone, the rebels still lack the punch to advance far. The colonel seems to be counting on divisions among NATO members thwarting any potential knockout blow. It is not a hopeless strategy. "You don't wage war by committee," says a frustrated Western security officer in Benghazi, the rebel capital. But NATO is considering increased strikes and more American participation.

The rebels cling to hopes that their brothers in and around Tripoli, the Libyan capital, will rise up, despite evidence that many remain fearful of Colonel Qaddafi's goons. The rebels' proto-government also wants NATO to sabotage the colonel's supply lines, some of which are said to run through Algeria, amid indications that fuel is growing scarce in his domains. But such attrition will take time, and holds no guarantee of success. The colonel has weathered sanctions before. A tighter squeeze on petrol and food supplies could simply persuade even more of the three out of four Libyans who are still living under his rule that Colonel Qaddafi is right, and the outside world is targeting Libya's people and not merely its leader.

Are there any alternatives to fighting? Last month Mohammed Ismail, a Libyan government envoy, arrived in London singing the merits of Saif al-Islam, the most visible of the colonel's sons and a man once touted as a possible force for liberalisation. Africa's envoys have also beaten this drum, proposing that Saif lead a four-year transitional government while a new constitution is drawn up.

Some cynics note that several rebel leaders are indebted to Saif for their return from exile, their business licences and in some cases their Benghazi mansions. Mahmoud Jibril, the rebel's de facto prime minister, worked for Saif until shortly before the uprising. Having rewritten history once by casting themselves as victims of the colonel's rule, perhaps some might be tempted to rewrite it again. Saif's hopes for succession took a battering after he echoed his father's threats to scorch Libya's earth should he fall. Lest anyone doubt his intent, he endorsed the repression that has already cost thousands of lives and left oil installations aflame.



The youths who launched the revolution are unlikely to be as ready to abandon it as some of the rebel councillors who appointed themselves their leaders. Protesters recently prevented a Turkish aid ship from docking in Benghazi, the rebel capital, incensed that Turkey had sought to obstruct NATO's military operations. They also greeted the peacemaking leaders of Mali, Mauritania and Congo-Brazzaville with cries of murder. At least two of the delegates, they charged, had supplied the colonel with mercenaries to fight the rebels: one defecting Libyan diplomat estimates that Mali has sent 4,000 fighters in exchange for Libyan largesse.

Meanwhile, the ministers gathered in Qatar sounded eager to fight. William Hague, the British foreign secretary, and Alain Juppe, his French counterpart, urged NATO allies to ramp up their efforts. Significantly, the earlier chorus of criticism from rebels doubting NATO's stomach for the fight has subsided. Mustapha Abdulrahman, a rebel spokesman, declared that there had been a "positive change" in the intensity of NATO attacks over the weekend. In short, all sides now seem ready to dig in for the long haul.

Index | Middle East & Africa

America in Africa

A light footprint

The Pentagon's unusual African arm

RARELY have American generals seemed less keen to claim glory on the battlefield. Those in charge of the Pentagon's Africa Command (Africom) are mightily relieved to have handed control of Libya's no-fly zone to NATO earlier this month, before the going got tough.

The orders from Barack Obama were to end their involvement within days rather than weeks, which they did. But the mission was never a comfortable fit. Africom is one of the oddest creatures in the American military. Its staff of 2,000 includes no regular troops, no "trigger-pullers", unlike its sibling Centcom, which oversees Iraq and Afghanistan.

Responsible for American operations in all African countries except Egypt, Africom was set up four years ago in the toxic aftermath of the Iraq invasion to pioneer a new form of defence, encompassing diplomacy and development. To avoid future high-profile wars, commanders were told to focus on "smart power": training national armies to keep the peace and to neutralise threats before they reach the headlines.

To do this, the Americans needed good relations with African leaders, many of whom were initially suspicious of the Pentagon. Nigeria and South Africa, the continent's military giants, have warmed to Africom in the past year. But the Libyan campaign has reignited fears of American domination.

After endlessly stressing that they will not drop bombs, the Americans face a high-pitched backlash. Things could get worse if Libya is de facto partitioned. Insecure neighbours may blame America for unleashing a secessionist bug, not least given its support for splitting up Sudan.

That would be unfair. America favours African stability above all else. It supported Sudan's partition only after all alternatives had failed. African leaders would do well to exploit America's new-found interest in the continent. Defence co-operation is already a boon to a number of governments. More than three-quarters of Senegalese officers have been to American war colleges, vastly boosting their professionalism. In the Sahara, weaker states are receiving help from Africom to fight al-Qaeda affiliates.

Still, some African suspicions are understandable. Making armies more capable could increase the risks of a coup, though Africom insists that greater professionalism also makes soldiers less political. Few, however, deny that America's role remains widely misunderstood.

The Pentagon-rightly obsessed with Iraq at the time-should have done a better job explaining Africom's mission when it was set up. Instead, the issue of where to base it dominated the debate. Many Africans wrongly assumed that America planned to build garrisons for armoured divisions on the continent.

In the end, most of the command ended up in sleepy and dour but prosperous southern Germany, perhaps the least African place in the world. Ensconced in manicured barracks with pitched roofs, its leaders have struggled to turn slogans into actions. Trained to fight rather than persuade, many are still planning responses to future conflicts instead of studying their potential causes so as to stop them before they become a real bother.

Yet most to blame for Africom's problems is the American political class. Not for assigning Africom the Libya mission and giving it troops and weapons. Combat operations were never excluded from Africom's mandate, merely downgraded. Rather, the politicians have failed to provide Africom with the main resource it needs to operate intelligently: trained civilian helpers.

A quarter of Africom's staff is meant to be made up of linguists, historians and other specialists. Yet 99.5% of Africom personnel are Pentagon employees. The State Department and other government agencies are too stretched to send experts. Congress happily pays for weapons but despises weaselly diplomats and woolly development aid, yet they are vital to ensuring that arms stay sheathed.

Index | Middle East & Africa

Israel's animal kingdom

What a zoo

A corner of cheerful coexistence in a largely segregated city



FOR the peccaries at the Jerusalem Biblical Zoo, it is a familiar experience. Dark-clothed humans appear disgusted when they spot them from afar, and then, drawing nearer, suddenly beam smiles and benevolence. The pig-like animals from South America have a comforting sign on their enclosure. "Doss is nisht a chazer," it assures Yiddish-speaking visitors from the city's ultra-Orthodox Jewish community: "This is not a pig."

The same assurance appears in Arabic, too, for the thousands of Muslim visitors. Neither religion positively enjoins zoo-going. But the director, Shai Doron, tries to be accommodating. A signpost near the kangaroos, making the sacrilegious claim that the continents shifted 40m years ago, used to be defaced almost daily. Now it has been subtly reworded to "many years ago", and peace reigns.

For Mr Doron, in fact, religious strictures are a boon. His carnivores get all their meat and poultry at knock-down prices from Jewish slaughterhouses. These call the zoo whenever a butchered animal is ruled unkosher. Many Jewish disqualifications also apply under Muslim halal law, so the unkosher meat is forbidden for sale to Arabs, too. The zoo, the most-visited site in Israel that charges admission, gets no state money.

Mr Dron prides himself on cutting-edge zoology. One notable success involves a pair of homosexual vultures, Jake and Judah, who hatched and raised three chicks over three years. All were successfully released into the wild. This story, biblically challenging, is not signposted on the vultures' enclosure.

Index | Middle East & Africa

Syria's unrest

At boiling point

Protests are gaining ground despite a violent crackdown



The coffins keep coming

SYRIAN leaders are backing themselves into a corner by escalating a five-week-old standoff with protesters. At least 28 were killed across the country by security forces and thugs on April 8th. Four more were shot dead two days later in Banias after the army surrounded the coastal city and let loose the *shabiha*, a thuggish smuggling gang backed by the regime that has been responsible for violence elsewhere. Nearby villages including Bayda were raided. Human rights organisations say at least 100 residents were arrested in one day.

The government has signalled violence may increase further by issuing a warning that no tolerance or leniency will be shown. Apologist reports in state media are adding insult to injury.

Protesters see little chance of dialogue and are concluding that taking to the streets is their only option. Several hitherto peaceful cities have seen their first large demonstrations. Protesters' numbers are growing and demonstrations that have routinely taken place after Friday prayers increasingly continue into the week. Groups of women, absent from many of the protests so far, went out to demand the release of detainees from Bayda.

Violence is also causing anger in quarters where the regime used to have at least some support. In recent weeks, a number of sheikhs from the religious establishment have given their blessing to protesters. Kurds, long repressed by the Arab majority, rejected a last-ditch offer of citizenship by government officials and took to the streets.

The army and intelligence services may be dominated by loyalists. But civilian elements of the elite are showing the first signs of fraying, both because they support reforms and out of growing discomfort at the security forces' brutal and ham-fisted behaviour. Samira Masalma, editor of the state-run *Tishreen* newspaper, has been sacked after criticising shootings by armed units. Several of her relations are said to have been injured during protests in the city of Deraa. Several soldiers have been shot, some reportedly for refusing to fire on unarmed protesters.



All this has upped the ante for Syria's president, Bashar Assad. He could have tried to quell demonstrations early on with sincere offers of reform, but he did not want to be seen as weak. Instead he opted for modest and unconvincing reform proposals. Tardy pledges to lift decades-old emergency laws and allow independent political parties have so far gone unfulfilled. A new cabinet-whose make-up could signal the government's future direction-has yet to be formed.

The government's main focus in public pronouncements is to warn protesters against a collapse into sectarian strife. This resonates strongly with ordinary Syrians who have witnessed the recent sectarian conflicts in neighbouring Lebanon and Iraq. Still, Mr Assad's scare tactics may not work.

A national banner

Sectarianism has not been a big part of the protests. An open letter in *al-Safir* newspaper by leading artists stressed the importance of Syrian unity. Kurdish groups have been careful not to frame their grievances as a bid for autonomy or independence. Many protesters seem keen to emphasise the national nature of the demonstrations, chanting support for faraway cities on the receiving end of the government's heavy-handed tactics.

As protesters become increasingly frustrated, their demands have grown. They now want not just the scrapping of emergency laws but the end of unchecked government powers, as well as true economic freedom and an end to corruption and elite privileges. From there it is only a small step to demanding the outright end of Mr Assad's rule. Some have already taken it.

Index | Middle East & Africa

Egypt's revolution

Staggering in the right direction

Ex-president Hosni Mubarak and his sons are detained

SEVERAL other would-be revolutions in the Middle East have stalled or descended into civil war. But the biggest so far, in Egypt, is still going strong and also remains mostly peaceful. On April 13th Egyptian police detained the country's former president, Hosni Mubarak, as well as his two sons. The Mubaraks face a possible trial on charges of corruption and abuse of power, a humiliation unprecedented for a former leader not only in Egypt, but across the wider Arab world.

Toppled in February after weeks of mounting protests, Mr Mubarak had spent the past two months confined to a cliff-top villa in the beach resort of Sharm el-Sheikh. The generals running Egypt during what they promise will be a swift transition to democracy have backed calls for the prosecution of former regime figureheads. Yet they had appeared reluctant to land the biggest fish of all. They shielded Mr Mubarak out of respect for his three decades of service as their commander-in-chief. But pressure from the public proved unrelenting.

After massive protests on April 8th, including a threatened renewal of the sit-ins at Tahrir Square in the heart of Cairo, state prosecutors hauled in the 82-year-old former president and his two sons. The Mubaraks stand accused of amassing illegal wealth, and of responsibility for brutal police tactics blamed for the deaths of more than 800 protesters in January.

Alaa and Gamal Mubarak were remanded in preventive custody, joining a growing roster of imprisoned former officials that includes a prime minister, several ex-cabinet members and leaders of the ousted ruling party. The former president himself has been transferred to hospital, amid rumours that he has suffered a mild heart attack.

The arrest and pending trial of Mr Mubarak will disturb some in Egypt who would prefer to see his legacy and the prestige of his position preserved. But it has brought relief to revolutionary hotheads, who are demanding retribution for the failings of his 30-year rule, as well as to those who believe the often wildly exaggerated tales of a vast fortune that the Mubaraks are said to have salted away.

There have also been signs of a growing distance between the public and the army. Symbolic as it may be, the prosecution of the former president and his family comes as timely proof that Egypt's army, which has often appeared to be aloof and insensitive, remains broadly responsive to the views of the street.

Egypt's army won praise for refusing to save Mr Mubarak's regime, for gently easing him out of office and for helping to restore order after the revolution's early tumult. But the Supreme Council of the Armed Forces, comprising 18 top generals headed by Field-Marshal Muhammad Hussein Tantawi, who served for 20 years as Mr Mubarak's defence minister, has proved a somewhat erratic ruling body.

In March the generals invited Egyptians to vote in a referendum, heralded as their first taste of real democracy, to amend eight articles of Egypt's constitution. Having won a yes vote, they then abruptly issued a decree imposing an abbreviated, temporary constitution comprising 55 additional articles, intended to outline the shape of Egypt's state until a new constitution is drafted, following a parliamentary election in September. The decree aroused only muted controversy, yet it called into question the point of holding a referendum in the first place.

Despite efforts at dialogue with the disparate political groups that led Egypt's revolution, the army has often appeared reluctant to move except to stave off renewed protests. A purge of former officials, including provincial governors, newspaper editors and university presidents appointed by Mr Mubarak, has been halting and remains incomplete.



The army's attempts to impose order on Egypt's streets have been marred by occasional brutality, including torture, and were tarnished further by official denials in spite of abundant evidence. In a typical response during a television interview, one member of the supreme council enthused that, in the new Egypt, freedom of expression is guaranteed "so long as it is respectful and doesn't question the armed forces". This may explain why a military tribunal has sentenced Maikel Nabil, a 26-year-old blogger, to three years in prison for detailing alleged abuses by the army.

Egypt's post-revolutionary trajectory has not been smooth, and it will probably be bumpy for months to come. Politics remains fragmented and fraught with fears and suspicions. Talk abounds of an Islamist takeover or a relapse into authoritarian rule. The country's economy is struggling to recover from slumping investment and reduced income from tourism, even as workers demand higher wages. Yet Egypt's overall mood remains buoyant. In an online poll taken by Egypt's most popular political website, after news of Mr Mubarak's arrest, barely 5% of respondents said they doubted the present government's will or ability to achieve the goals of the revolution. Three-quarters said they were cautiously optimistic. Arabs elsewhere in the region can only look on in envy.

Corruption in eastern Europe

From Bolshevism to backhanders

Corruption has replaced communism as the scourge of eastern Europe



LETA News agency/Alamy

JUTA STRIKE won't say where she has spent the past few weeks. But the fact that Latvia's best-known anti-corruption official (pictured above) had to leave the country for her own safety, amid political attempts to nobble her agency, is evidence of a rising tide of sleaze in ex-communist Europe, and of the troubles, and even dangers, facing those who try to tackle it.

A corruption scandal that links a political party to a private security agency is rocking the Czech government. In Bulgaria brazen attempts to rig a nuclear-power tender seem to have left politicians helpless. In Romania and Slovakia attempts to reform the judiciary have stalled. Even starry-eyed outsiders who win elections on anti-corruption tickets seem to be captured by the system within months.

Corruption is hard to measure and varies widely. Estonia is cleaner than some west European countries; few easterners have a reputation worse than Greece. But it is striking that even hardened warriors in the war against sleaze are so gloomy. Alina Mungiu-Pippidi, a Romanian campaigner and academic, likens the corrosive effects of rent-seeking from corrupt governments to the curse of easy money from oil and gas in Russia. Anti-corruption efforts have failed to engage the wider public, she says, so activists soon become dispirited.

Jan Urban, a doughty Czech ex-dissident turned clean-government campaigner, agrees. "You need at least a bit of success", he says. Activists in Czech groups with such names as "Defenestration" and "Change the Politicians" gleefully ousted much of the old guard in an election last year. But the new government has descended into squabbling, shown itself to be in hock to business interests and failed to deliver on its sleaze-busting promises.

The causes are manifold. The financial crisis has made people readier to cut corners. Whistleblowers are ill-protected. Firms not willing to pay bribes lose out to those that are, such as Russian, and increasingly Chinese, competitors.

Businesses fear that taking a stand will bring retribution: bureaucratic harassment, arbitrary tax demands or missing out on public contracts. Leverage from the European Union loses its force once countries have joined. Indeed, the billions of euros flooding from Brussels to modernise infrastructure and public services often prove a fount of corruption. Companies, politicians and officials collude to rig tenders, usually with impunity: legal scrutiny is weak, and voters seem apathetic and cynical.

The media are given to indiscriminate barking but little biting. Puny editorial budgets mean that investigations fizzle out. Advertising campaigns associated with publicising EU contracts and rules give great power to officials and politicians wanting to reward favourable coverage. The biggest advertiser in Lithuania, for example, is the agriculture ministry. There is scant critical scrutiny of its activities. State-owned industries often play a similar role.

Profitability in the media has plunged since the financial crisis. That has made many foreign owners eager to unload their ailing assets; influence-hungry local tycoons have found plenty of bargains. The Swedish owners of Latvia's main daily, *Diena*, sold it via an obscure chain of transactions to an unknown owner. Many of its senior journalists, including those involved in anti-corruption investigations, have left or been fired.

The only investigative programme on Czech public television came under pressure after it scrutinised some startling legal manoeuvres surrounding the government's mistreatment of a foreign blood-plasma company. "This is typical of the way in which governments of all stripes have tried to squash investigative journalism," says Mr Urban. Having faced down the communist-era secret police, he is not scared of a lawsuit against his caustic blog. But the threats continue elsewhere.

Tycoons tilt the media field by subsidising tame outlets. Bodo Hombach, the boss of WAZ, a big German media investor, has said that "the close intertwining of oligarchs and political power is poisoning the market." Such owners, he claimed, were buying up the media to exert political influence, not in search of profit. Some worry about a descent to Italian standards.

Solutions are rare. Voters hanker for a strong hand, perhaps from the spooks. But as Russia shows, that cure can be worse than the disease. Ivan Krastev, a Bulgarian analyst, says that the real problem with corruption is the complicity it creates. "We end up with shadow networks that make countries ungovernable, or governable by somebody else." Just 20 years after it regained its freedom, much of eastern Europe risks compromising it.

Index | Europe

Italy and immigration

Take my migrants, please

An influx of north Africans causes a headache for the government



IT WAS what Italians call a *sfogo*: a release of pent-up emotion that contains a dose of hyperbole. But it still came as a shock when, on April 11th, Roberto Maroni, Italy's interior minister, mused aloud about leaving the European Union, after attempts to persuade his counterparts to share Italy's illegal immigration burden fell flat.

Mr Maroni's Northern League, and the conservative government of which it is part, are in a fix because of north Africa's unrest. The League is committed to blocking illegal immigration. For a while it claimed to have done so. Last year the number of migrants arriving by sea was negligible because of deals with Libya and Tunisia to clamp down on trafficking in the Mediterranean. The boast was specious-most illegal immigrants enter Italy by less visible means-but politically effective.

Now Italy's migration policy is in ruins. Since the start of the Arab spring more than 25,000 people have arrived in Italy by sea, many on the tiny island of Lampedusa. Most are Tunisians fleeing the economic problems that helped trigger the upheaval. The interim government in Tunis, which is facing a massive refugee problem of its own on the Libyan border, has been reluctant to give priority to helping Italy.

But on April 5th it agreed to take two flights a day of repatriated migrants. In return Italy offered the Tunisians coastal-patrol equipment and euro150m ($220m) in unspecified support. Italy hopes the sight of returning migrants will deter others from trying. The risks were brought home last week when a boat carrying over 200 passengers capsized; only 48 survived.

From the EU Mr Maroni sought another deal to allow him to dispatch migrants, but in the opposite direction. He-and his colleague from Malta, which has also been hit by an influx of north Africans-wanted the EU to apply an emergency rule to relocate the refugees across all member states.

This was blocked. But Italy had already issued national residence permits to the migrants, perhaps hoping they would exploit the passport-free Schengen area to slip across to countries like France, where many Tunisians have family. The French, however, pointed out that the Schengen rules grant freedom of movement only to those with proper passports and the means to support themselves. Others can be returned to the EU country in which they arrived. The French have already sent almost 2,000 north Africans back to Italy.

France and Germany argue that, since Italy receives proportionately few requests for asylum (just over 10,000 last year, compared with France's 52,000 and Germany's 49,000), it should cope with the relatively modest influx from north Africa. Privately, ministers in Rome accept that the present levels are manageable. But they worry that the Libyan conflict could unleash a bigger exodus, and want the EU to work on a comprehensive approach.

No Libyan government is likely to care about Italy's fears. The rebels remember the pally relationship between Muammar Qaddafi and Silvio Berlusconi, the Italian prime minister (who this week said he would probably stand down when his mandate expires in 2013 and named a possible successor, Angelino Alfano, the justice minister). The colonel will feel betrayed by his former ally's decision to join NATO's offensive-and on April 12th Mr Berlusconi said he had to be talked out of resigning after changing sides.

With Italy's Maghreb policy in disarray, the Northern League appears bent on making things worse. Its leader, Umberto Bossi, has backed a boycott of French goods. And a League junior minister has talked of opening fire on vessels carrying migrants-though "not for the moment".

Index | Europe

France's presidency

Yes he Kahn!

Dominique Strauss-Kahn seems set to run for president



Dark suits are for ultra-liberals

FOR months, a favourite political parlour game in Paris has been to guess whether Dominique Strauss-Kahn will run for president in 2012. As head of the IMF, the Socialist ex-finance minister is contractually forbidden from commenting on French politics. Each time he passes through Paris en route to some crisis, he refuses point blank to reveal his plans. French talk shows keep asking if he has made up his mind. But all the signs are that Mr Strauss-Kahn is now ready to run.

The evidence comes in various forms. A source close to the IMF says that Mr Strauss-Kahn's diary is busy in May, but clear after that. The talk in Washington has already turned to who might replace him. Anne Sinclair, Mr Strauss-Kahn's wife, told a French magazine that she does not want her husband to run for a second IMF term after his first one runs out in November 2012. He has a communications agency ready in Paris. He took part in a recent fly-on-the-wall television documentary, which opened with him expressing his disappointment at Jacques Delors's decision in 1994 not to run for president-and in which he sported a T-shirt made by supporters with the logo "Yes we Kahn!"

Mr Strauss-Kahn's associates in Paris are also adamant. "Of course he's going to run," says one. "The only question is when he will announce it." Under party rules, candidates for this autumn's primary to elect the presidential nominee must declare by July 13th. The best guess is that Mr Strauss-Kahn will quit the IMF and declare in late May or early June.

Although the favourite, he is not guaranteed to win the primary. At the end of March a slimline Francois Hollande, the Socialists' former leader, became the latest to throw his hat in. He joins Segolene Royal, his former partner and the party's defeated 2007 presidential candidate, as well as younger aspirants like Manuel Valls and Arnaud Montebourg. Mr Strauss-Kahn also has to hope that Martine Aubry, the party's leader, will honour a deal the pair made not to run against each other.

The race may not end up as crowded as it now appears. Some of these names could drop out in return for the promise of a job in any future government. Much will depend on whether Mr Strauss-Kahn can keep his lead in the polls, and whether he can use it to impose himself, a moderate, on the Socialist party's left wing.

The polls have consistently shown that Mr Strauss-Kahn is the Socialist best placed both to squeeze out Marine Le Pen, the far-right National Front leader, in the first round of the presidential election, and to beat President Nicolas Sarkozy in a run-off. One recent poll also found that most people believed he would win in 2012. While out of the country, Mr Strauss-Kahn has been able to glide above the grubby business of French politics. The moment he hangs up his IMF suit, however, his aura of invincibility will fade.

His poll numbers have started to drop, and those of Mr Hollande, notably, to creep up. This makes it harder for Mr Strauss-Kahn to appeal both to moderate Socialists and to the left. The continuing influence of the latter was confirmed last week with the publication of the party's draft manifesto, an old-style tax-and-spend document. Mr Strauss-Kahn may have the allure of a globetrotting statesman who got the big calls during the recession right, and he is highly regarded at the IMF. But the French link him to austerity and cuts. The far left has branded him *ultra-liberal*, a stinging insult in France. With his years on a big salary in Washington, not to mention a rich wife and a house in Marrakech, Mr Strauss-Kahn needs to show that he is in touch with ordinary folk.

Doubtless mindful of this, the IMF boss has talked in recent speeches about globalisation's "dark side" and the need for social inclusion. This week, in Washington, he took part in a debate with a trade-union leader on global unemployment. "He has the stature," says one Socialist insider, "but does he have the legitimacy?" It is a gamble, but one that Mr Strauss-Kahn finally looks ready to take.

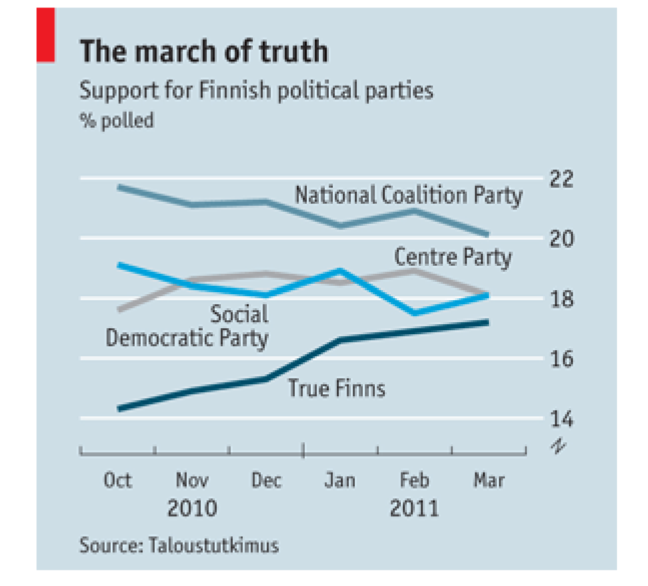
Index | Europe

Finland's election

Race to the Finnish

Europe prepares nervously for a strong showing by the True Finns

FINNISH elections do not usually excite much attention abroad, still less apprehension. A long border with Russia gives Finland strategic significance, but it is a small place with a reputation as a stolid member of both the European Union and the euro zone. Most election campaigns feature a dozen or more parties. The one that wins the most votes invites two or three others to form a coalition-and nobody loses much sleep. But the election on April 17th may break the mould because of the astonishing rise of a populist Eurosceptic party, the True Finns, led by Timo Soini.



Many Finns are bored by their familiar politicians. A recent survey found that one-third of voters could not name the four parties in today's coalition. By contrast, Mr Soini's soundbites about helping impoverished Finns instead of bailing out profligate Greeks or handing cash to immigrants have struck a chord. The True Finns took just 4.1% of votes in the 2007 election, but they are now almost level in the polls with the three bigger parties (see chart). It is anybody's guess which party will emerge as the biggest on polling day, and thus probably supply the next prime minister.

Some Finns see Mr Soini as a breath of fresh air. But others echo concerns elsewhere in the EU about his potential as a refusenik. Even before the election, Finland had emerged as an awkward partner in EU negotiations; in late March it scuppered plans to expand the size of the euro-zone bail-out fund, for example.

A likely rescue for Portugal, which requested a bail-out on April 6th, has become an election issue. Mari Kiviniemi, the centrist prime minister, cautions against risking recession by undermining the markets. The opposition Social Democrats call for bankers and investors to act responsibly. But the True Finns are dead against help for Portugal.

With the three main parties all pro-EU and euro, it is hard to see how the True Finns could fit into a coalition. Mr Soini suggests that his party could enter government with an independent line on European matters. But other parties reject this idea. Having "one foot in government and the other outside" is unimaginable, says Pekka Ravi of the National Coalition Party (NCP). Mr Soini's reply is to insist that his party will now aim for "outright victory". He pledges to seek referendums on future euro rescues.

Such talk is causing alarm in Brussels and Frankfurt. Yet pre-election posturing is the Finnish norm. Instead of campaigning in blocks, each party fights alone. The political horse-trading starts only after the votes are counted. Moreover, Finland's mainstream parties may yet find a way to keep the difficult Mr Soini out of government. The problem for their European partners is that his attitudes have already infected it.

Index | Europe

Turkey and its Kurds

South by south-east

Pro-Kurdish candidates for election are likely to do well in Turkey's south-east



The Kurds are sticking to their own

LEYLA ZANA, a popular Kurdish politician, once declared: "I no longer believe in the Turkish parliament. I will not run again." In 1991 she won a seat in the mainly Kurdish province of Diyarbakir, in south-east Turkey. Three years later she was stripped of her parliamentary immunity and sentenced to 15 years in prison for belonging to the Kurdistan Workers' Party (PKK), a group of armed insurgents. Her biggest crime was to accompany her oath with a short speech in Kurdish. No matter that she called for brotherhood between Turks and Kurds; she spent ten years inside.

Now Mrs Zana is running for parliament again. Along with other members of the pro-Kurdish Peace and Democracy Party (BDP), she is standing as an independent to get round the 10% threshold parties must reach to win seats. Mrs Zana's turnaround reflects changes in Turkey since the days when she was blindfolded, tortured and paraded naked before male prisoners. Now she is free to campaign in Kurdish. She can be interviewed by Turkey's first state-run Kurdish television station, TRT 6, and by private Kurdish television and radio stations, which have mushroomed. Ahmet Turhan, governor of Batman province, concedes that education in Kurdish can be considered and that the state should apologise for past misdeeds. And secret talks continue, if sporadically, between the government and Abdullah Ocalan, the imprisoned PKK leader.

This more relaxed attitude owes much to the mildly Islamist Justice and Development (AK) party, which shot to power in Turkey in 2002. Riding a wave of robust growth, democratic reforms and international acclaim, AK is expected to win a third term of single-party rule on June 12th. But it is unlikely to repeat the drubbing that it gave the BDP (then known as the DTP) in Kurdish areas in 2007.

There are several reasons for AK's ailing fortunes among the country's 14m Kurds. They are no longer swayed by free coal and talk of Islamic fraternity. AK's "opening", which was meant to lead to an amnesty for PKK rebels untainted by violence, has been shelved. Recep Tayyip Erdogan, the prime minister, blames the Kurds. He says the PKK provoked Turks in 2009 when fighters returning from Iraq started delivering "victory" speeches.

The government's response was to lock up thousands of Kurdish politicians, including BDP mayors. Selahattin Demirtas, a BDP leader, reels off the figures. At least 2,300 Kurdish activists have been jailed since 2009. Sentences sought by prosecutors in an array of cases against the BDP's 22 parliamentarians, including Mr Demirtas, add up to a staggering 2,350 years.

Egged on by Mr Ocalan, the BDP has raised the bar with a civil-disobedience campaign that has seen a Kurdish female parliamentarian slap a policeman. Kurds are spurning mosques staffed by state-appointed imams in favour of Kurdish-language prayers in fields. Their campaign will not end, they say, until BDP prisoners are released, an amnesty is given to PKK fighters, education in Kurdish is permitted and the 10% threshold is lowered.

The strategy is paying off. Analysts reckon the BDP could win some 30 seats in June's election. AK's case has not been helped by the lacklustre candidates it is fielding in the south-east. This may be a good thing. The more Kurds there are in Ankara, the more comprehensive will be the new constitution Mr Erdogan promises to deliver after the election.

Those who complain about BDP "provocations" ought to remember their own calls for the PKK to end its armed struggle and to let politicians pursue Kurdish goals peacefully. The PKK has extended its unilateral ceasefire until the election. After 12 years of captivity Mr Ocalan is, for now, easing his iron grip on the PKK (and, by extension, the BDP). The BDP looks less like the political wing of the rebels; instead, the PKK now looks like the BDP's armed wing. Yet until the Kurds' demands are met that wing is unlikely to be discarded.

Index | Europe

Bosnia's future

Divided and unruled

The country is in deep trouble, even if renewed violence remains unlikely



ON APRIL 1st the world and European football associations suspended Bosnia, apparently killing whatever hope the country had of qualifying for the Euro 2012 championships. FIFA and UEFA had asked Bosnia's football federation to replace its three-man (Serb, Croat and Bosniak-Muslim) presidency with one person, but the Serbs refused. This week FIFA revived Bosnians' dreams by imposing a "normalisation committee" on their football federation. But saving the country will be harder. Local politicians say it is going through its worst crisis since the war ended in 1995. Progress on much-needed economic reforms, or towards European Union membership, has ground to a halt.

Bosnia has been virtually ungovernable since a set of modest constitutional changes failed to pass in 2006. Milorad Dodik, president of the Serb-dominated bit, the Republika Srpska, openly calls for Bosnia's dissolution. A Serbian Orthodox church is being erected, illegally, near a memorial to 8,000 Bosniaks murdered by Serb forces in Srebrenica in 1995. Bosniaks will make their annual pilgrimage there in July; some fear anger over the church could lead to violence.

Even more worrying is the troubled Bosniak-Croat federation. The multiethnic, though mainly Bosniak, Social Democrats won last October's election. But the two main Croat parties refused to join them in government. Following a series of manoeuvres, the Social Democrats' leader, Zlatko Lagumdzija, scratched a government together, which was challenged in court. The challenge was withdrawn, but the Croat parties still do not recognise the government.

Martin Raguz, a Croat leader, says that the constitution agreed in 1995 to end Bosnia's war has hit a brick wall. He wants a new election. No way, retorts Mr Lagumdzija. He has formed a government, he says, and politicians like Mr Raguz cannot stomach the fact that he is trying to end Bosnia's ethnic segregation.

Mirsad Kebo, a Bosniak and one of two federation vice-presidents, hopes wisdom will prevail. He would prefer Croats like Mr Raguz to join the federation government, but says they have asked for too much. Mr Raguz replies that, since 1995, Bosnian-Croat influence has been steadily whittled away by the Bosniaks. As for Mr Dodik, he has now formed an unlikely alliance with the main Bosnian Croat leaders. They have even signed an agreement to form a state-level government together. But they cannot do this without Bosniaks.

The ongoing gridlock means one must prepare for the worst, says one diplomat. Could that mean a return to war? Probably not. Srecko Latal, an analyst with the International Crisis Group, says there is no intent or preparedness for violence. Mr Kebo, likewise, does not fear war. One reason for this, he says with a hint of steel, is that nobody (ie, neither Serbs nor Croats) has any chance of destroying the state of Bosnia and Hercegovina.

Yet outside help may be needed. The EU has agreed in theory to impose a travel ban on anyone deemed a threat to the country. That may not be enough. Writing in *The Times* this week, Paddy Ashdown, a former pro-consul, urged the West to become engaged again. Otherwise, he warned, Bosnia risked break-up, and even fresh conflict.

Index | Europe

Charlemagne

A parable of two debtors

Does Iceland hold lessons for Ireland, and the rest of troubled Europe?



EVERYONE in Iceland knows the tale of Bjartur of the Summerhouses, a crofter who, emerging from years of debt bondage, struggles against nature, misfortune and the curse of Ireland's St Columba to be self-reliant. "The man who lives on his own land is an independent man," he tells his dog. "He is his own master."

The appeal of Bjartur, the central character in "Independent People", an epic novel about Iceland's peasantry, did much to secure the Nobel prize for its author, Halldor Laxness, in 1955. More than half a century later, Bjartur's cussedness lives on. For the second time, Iceland's people have voted to reject a deal to compensate Britain and the Netherlands for making good local deposits in the island's collapsed banks. No matter that the revised deal offered Icelanders more favourable terms. Nor that the country faces prolonged economic uncertainty and a Dutch threat to hold up its bid for European Union membership.

The "no" camp argued that Iceland had no legal duty to stand behind euro4 billion ($6 billion) of compensation to foreign depositors in Icesave, the online arm of a failed private bank, Landsbanki. The matter will now go to an international court, although Iceland says most or even all the money will be repaid from the disposal of Landsbanki's assets. Beyond the legal arguments, the vote was an act of defiance. Icelanders were offended at their treatment by big countries, notably Britain, which had invoked anti-terrorist laws to seize Icelandic assets.

There is an epic quality about the way this remote island of glaciers and volcanoes has stood up to powerful states and economic orthodoxy. For its cheerleaders, such as Paul Krugman, an American Nobel laureate in economics, Iceland is a model for another north Atlantic island ruined by bad banks: Ireland.

Yet the Irish government has taken the opposite view. It guaranteed the obligations of Irish banks to a reckless degree, wrecking the country's public finances. It then accepted a bail-out from the EU and IMF on the understanding that it would not try to burn the senior bondholders of Ireland's bust banks. Why? Because many of them are other European banks, and imposing losses might spread financial infection. Enda Kenny, the new prime minister, has recoiled from acting on his election promise to make the bankers share the pain. Some left-wing parliamentarians have demanded an Iceland-style referendum on the conditions of Ireland's bail-out. Look, they say, the sky has not fallen in on Iceland. (Portuguese activists are also calling for a referendum on any planned austerity measures.)

Yet Iceland made a virtue out of necessity. Irish banking assets were three times as big as national output; Iceland's were ten times as large. Irish banks were too big to fail; Icelandic ones too big to save. Iceland salvaged only the domestic banks, letting foreign operations go to the wall. It imposed capital controls and suffered a sharp devaluation.

So which has done better? The two islands experienced similar losses of GDP. Unemployment has been higher in Ireland, but Iceland has endured a bigger drop in domestic demand, and saw inflation reach 18% (it is now back to normal levels). The IMF predicts that Iceland will grow faster than Ireland this year and next, with half Ireland's jobless rate. Iceland's deficit and debt levels, and its credit-default swap spreads (a sign of investor confidence), look healthier than Ireland's. Steingrimur Sigfusson, Iceland's finance minister, says his country could "amaze the world with a speedy and good recovery".

Not all Icelanders are so upbeat. Magnus Arni Skulason, a prominent campaigner for a "no" vote in the first Landsbanki referendum last year, says he is concerned about the uncertainty that a second rejection will cause. Iceland faces another downgrade by the rating agencies. Capital controls are likely to stay in place for several more years. Emergency loans from Nordic countries may not continue (Carl Bildt, the Swedish foreign minister, blogged that the vote was "worrying"). Iceland's ability to raise exports is hampered by current aluminium-production capacity and fish stocks. Thorvaldur Gylfason of the University of Iceland, who issued early warnings about Iceland's over-large banking sector, says it is too early to assess the long-term damage, be it difficulty in raising finance or intangible effects such as a loss of business confidence and the "recriminalisation" of a business class seeking to get around capital controls. "We should not be banging our chests and saying we got away with it."

In Ireland, economists such as Philip Lane of Trinity College, Dublin, see risks in following Iceland's example. Ireland relies, as a launch-pad for multinationals, on its place in the EU. It survives on liquidity from the European Central Bank, and in any case cannot afford to cut itself off from Europe.

Between Ice and Ire

The right answer surely lies somewhere between Ireland's near-comprehensive guarantee for the banks and Iceland's bank default. The Irish state should bear some consequences for its mismanagement in allowing the housing bubble to inflate so far. But the senior bondholders of Irish banks should also take a hit.

European financial stability need not mean making Irish taxpayers pay onerous interest rates solely to help wobbly German banks. Even the European Commission thinks the bail-out's cost is too high. It might be better to restructure or recapitalise those foreign banks most exposed to Ireland.

The story of Bjartur cautions against overzealousness. His quest for self-reliance ends in failure, and those dearest to him pay the heaviest price. "The lone worker will never escape from his life of poverty for ever and ever; he will go on existing in affliction as long as man is not man's protector." In the end, Bjartur succumbs to the markets and St Columba.

Economist.com/blogs/charlemagne

Index | Britain

Bank reform

Commission accomplished

An eagerly anticipated inquiry into the future of banking has proved palatable to both politicians and the industry. But the real battle might be to come



OVER the years many establishment worthies have agreed to chair inquiries for governments, only to see their conclusions sink without trace, ignored even by their patron. Not so Sir John Vickers. His Independent Commission on Banking published its initial report on April 11th, to the kind of reception normally reserved for pyrotechnic probes into wars. Debate over its proposals dominated the airwaves; the commission even won the accolade of seeing its website crash under overwhelming traffic.

The excitement reflects the still-seething public anger about how poorly Britain's banking system and regulators performed before and during the financial crisis. The politics of the coalition government are a factor too: the junior

partner, the Liberal Democrats, made tough action on the banks a condition of signing up to the coalition pact after the general election last year; the Conservatives have been less keen to clobber Britain's big banks.

The Bank of England, meanwhile, seems to be struggling to come to terms with its new and all too practical responsibility for supervising the banks. Lastly, some firms, including Barclays and HSBC, have said they might move their headquarters from Britain if regulation gets too tough-clumsy threats, perhaps, but not specious enough to dismiss out of hand.

That is a mightily confused and difficult set of constituents to please. Even getting the five commissioners-a feisty bunch, some of whom had expressed their mistrust of big finance in public before they got the tap from the Treasury-to agree was an achievement. Depending on your point of view, their report suggests that, after months of hearings, they have either been psychologically crushed by the power of the banking lobby or have become suitably informed about how banking works. The most dramatic options, notably breaking up big firms, have been rejected.

Solomonic or soporific?

The commission's first proposal is that the cuddly parts of banks-their high-street operations and the payments systems they run, which account for between 15% and 45% of British banks' overall balance-sheet-should be financially ring-fenced, with their own balance-sheets and legal structures. In theory this solution might retain some of the economic benefits of having diversified banks, with both retail and investment arms; but, if the banks got into trouble again, it might allow the state to rescue only the bits of them that really matter to the public. As a useful side effect, if the plan worked the banks' investment divisions could no longer benefit from the expectation of state support, which allows them to borrow cheaply.

The commission's second big suggestion is that banks should carry more capital than the new international rules require. And third, it reckons that Lloyds Group, formed by a massive merger-from-hell sponsored by the previous government during the crisis, should be forced to shrink its market shares in retail-banking products, typically over 20% now.

George Osborne, the Tory chancellor of the exchequer, welcomed the report; Vince Cable, the business secretary and the Lib Dems' bank-basher-in-chief, appeared to accept it. That probably means a potentially nasty political tussle has been averted. But exactly what the commission's findings mean for the banks is still unclear.

Detailed discussions have been held with the banks about ring-fencing, but uncertainties remain. One is how much the retail part of a bank could lend to the rest of the firm. This issue is critical, says one bank, since it will determine whether investment banks have access to retail banks' deposits. The commission's instinct seems to be to take a fairly tough stance on intra-bank lending, but its precise views are hazy. On Lloyds, the commission said it wanted more branches to be sold than is currently envisaged by a disposal plan drawn up by European regulators. But it has not been specific.

Finally, there are ambiguities over capital requirements. Over and above their core capital (basically shareholders' equity), the commission wants banks to carry debt that can be converted into equity during a crisis to boost their safety buffers. But the amount has not been stipulated: this is, apparently, where the commission will next focus its intellectual wattage. An extra layer of 5% or so of such debt (measured against a bank's risk-adjusted assets) could be possible, which would put Britain's regime in between the minimum required by new international rules and the very tough new standards that Switzerland is about to impose.

And on core capital, the commission insisted that retail banks must hold a 10% ratio. But it only suggested that the rest of banks' operations, including their global trading arms, should do the same. The tacit hope seems to be that international regulators, who are pondering this issue, might be persuaded to enforce this idea globally.

If they are not, when the government comes to implement the commission's reforms, Britain might have to take a unilateral and potentially risky decision on higher capital requirements for entire banks, not just their retail arms. The commission is said to have given a lot of weight to the need to preserve the standing of the City of London, but to have concluded that having big British-run investment banks is not an essential ingredient of its success. It insists that it is not too bothered by the spectre of some banks decamping.

Might they go? One person involved with the commission says its members doubt it. Barclays is said to be the least pleased about the proposals; but even if it could move its headquarters abroad it would not escape the requirement to ring-fence its British retail arm and run it with higher capital levels. HSBC, which is focused largely on emerging markets, could probably live with the suggested reforms, providing that the final number the commission comes up with for overall core capital is not above 10%, and the extra layer of convertible debt is below 5%.

The commission's next and final report will be delivered to the government in September. Its interim document has, says one bank boss, "given the direction of travel" but the end game, he says grimly, is a "long way off". Sir John might have helped to muffle the political row, but in financial circles the real fight will continue. The final report will be replete with arcane terms and precise numbers, and will probably not get as much attention as this one. But in banking, technicalities are where battles are often lost and won.

Index | Britain

Schools reform a year on

Michael v the machine

The government's mission to shake up education has been a political struggle. It is beginning to succeed



Gove, a cerebral street-fighting man

OF ALL the government's reforms, none arrived in office inspiring greater expectations than the plan to expand choice and competition in schools. Whereas the Conservatives' now-controversial NHS policy was opaque before last year's general election, their thoughts on education were clear. The brief was entrusted to Michael Gove, one of the more cerebral cabinet members, who was broadly supported by the Liberal Democrats, the Tories' coalition partners. The policy even had admirers on the Blairite wing of the Labour Party, who, in office, had allowed some state schools to become "academies", liberated from most local-authority control in teaching and management.

At first those great expectations looked naive. The coalition wanted academies to proliferate, and entirely new "free" but state-funded schools to be set up by parents and charities. Yet only a dozen or so free schools were approved in the

summer in 2010-in line with ministers' predictions, but fewer than the hype portended. Nor was there a deluge of academies.

Like most Tory cabinet ministers, Mr Gove was originally prevented from choosing his own special advisers by Andy Coulson, formerly the government's head of communications, who wanted them to answer to Downing Street. Mr Gove struggled to prevail over sceptical civil servants, teaching unions who vehemently opposed his plans, and Ed Balls, his Labour opposite number until October. There were rumours of tension with David Bell, the education department's senior mandarin, who had also been regarded suspiciously by some Blairites.

Almost a year on from the election, reformers are more sanguine. After Mr Coulson quit in January, over a phone-tapping scandal connected to his previous life as a newspaper editor, Mr Gove was able to hire his own staff. David Cameron, whose prime ministerial style was at first that of a hands-off chairman, has become tenacious in backing his education secretary's fight with what some Tories now bitterly call "the machine" of Whitehall.

The numbers are up: 357 schools have converted into academies since September and 547 secondary schools, one in six, now have academy status. The ratio could reach one in four within a year. Ministers privately define success as half of all secondaries becoming academies by 2015. They are on course. By contrast, it took Labour four years to open the first 27 academies, and the previous Tory government five years to open 15 city technology colleges, forerunners of academies.

The huge number of conversions has overwhelmed teaching unions, who had hoped to take on schools aspiring to academy status through a combination of targeted PR campaigns and legal challenges. (Academies represent a serious threat to the power of the unions, as they are not bound by the deals on pay and conditions negotiated at national level.) They now have too many targets to aim at.

Despite the profusion of academies, the government will not be satisfied until free schools take off too. These are intended to add capacity to the state sector, and to embody Mr Cameron's vision of a "Big Society" in which citizens collaborate to provide services traditionally monopolised by the state. Ministers are confident: most interested parties were never likely to take the plunge in the first year, they say, and 17 free schools had been approved by February, out of 323 applications. Some, though, think the ban on for-profit firms setting up free schools might have to be lifted.

That would further rile the unions. But Mr Gove is now used to fighting.

Index | Britain

Supermarket offers

Not so special

Why shopping might be slightly less costly than official figures suggest

AFTER months of grim figures, inflation fell to 4% in March, even though analysts had expected it to hold steady at 4.4%. The decline reflected attempts by retailers, notably supermarkets, to trim their prices and tempt consumers into spending a bit more. So strenuous are their efforts, in fact, that the real-world inflation rate may even be slightly lower than the official one.



Overall, food inflation remains uncomfortably high (see chart), in part because of costlier raw materials. But those figures may overstate the extra costs to consumers. That is because retailers increasingly use promotions-discounts on specially displayed goods-to lure customers. Promotions accounted for 34.8% of grocery sales in the year to March 20th, up from 29.3% two years earlier, according to Kantar Worldpanel, a research firm. Promotions by supermarket chains accounted for 43.5% of their branded grocery sales.

These gimmicks often take the form of buy-one-get-one-free (or BOGOF) offers. This creates a headache for statisticians. BOGOF goods cannot be treated as half-price, since shoppers who want only one item still pay the full whack. The benefits vary: BOGOF or three-for-the-price-of-two deals are less valuable for perishable foods than for tinned goods. To avoid tricky judgments, number-crunchers collect the prices only of unbundled goods.

It is not only shoppers who benefit. Consumer-goods firms, which usually bear the cost of promotions, like to reduce prices temporarily in this way, because a permanent low price may damage a brand's power to project an image of high quality. A well-timed promotion can clear excess stock or, in austere times, stop consumers trading down to cheaper alternatives. Retailers like them as they add a dash of colour and buzz to shops, and because they can squeeze more money out of each customer through impulse purchases.

Still, promotions can also cause problems for others besides statisticians. Their marketing power is diminished by ubiquity. "Price promotions shift stock but they don't build brands," says Edward Garner of Kantar Worldpanel. Once the special offer is over, sales drop to their previous levels, and bargain-hunters move on to the next deal. Promotions confuse shoppers about pricing: a former boss of Asda called them "weapons of mass distraction". The spikes in demand they produce make stocks hard to manage for both retailers and their suppliers. Small, steady price cuts might actually be preferable all round.

But once firms start to use them, it is hard to stop. "It's an accelerating merry-go-round that everyone would like to get off," says Mr Garner. No business can afford to make the first move. The way out is stronger brands or new and better products that stand out. For the moment, however, promotions are likely to become still more prevalent-meaning that the official inflation figures will continue to overstate the cost of a trip to the shops.

Index | Britain

Radio and the internet

Tuning in

An old medium gets its digital act together



Someone still loves you

IT IS not as rich as television, nor as politically powerful as newspapers. But when it comes to the big challenge facing media-how to deal with the internet and technological change-radio is proving bolder than its peers. A groundbreaking online service launched quietly on March 31st is growing quickly, both in content and sophistication.

Radioplayer is both a website in its own right and a pop-up player embedded in stations' sites. It allows users to listen both to live radio and to archived programmes. The BBC's radio stations and most big commercial outfits are on it (an impressive achievement in itself, given the catfights that tend to break out between the BBC and commercial media). Michael Hill, who runs the service, expects hundreds of smaller ad-supported and community radio stations to join in the next few weeks.

At present most people still listen to old-fashioned AM / FM radios. Digital radios, which are easier to tune and have more stations, have sold surprisingly slowly. And internet radio seems to be stuck in a niche. Just 3% of live radio listening is via the internet, though the share is more than 5% for youth-oriented stations such as Kiss.

Online and, increasingly, on mobile phones, there is fierce competition from music-streaming services such as Last.fm, Spotify and we7, which allow users to assemble their own playlists. Many young people find these more compelling than radio. Using data from RAJAR, a ratings agency, Enders Analysis calculates that the average 15- to 24-year-old radio listener tunes in for almost 20% fewer minutes now than five years ago. As a result, advertising has drifted. Commercial radio brought in pound139m in the fourth quarter of 2010, down from pound160m in the same period ten years earlier.

Live radio has some inherent advantages over internet music-streaming services. Presenters and phone-ins humanise it, conveying "a sense that you are not alone in the world", says Steve Parkinson of Bauer Media, which runs Kiss and Magic. Radio also helps people discover new music. Its big disadvantage is that it cannot be searched easily. Radioplayer introduces a search function, albeit a rudimentary one.

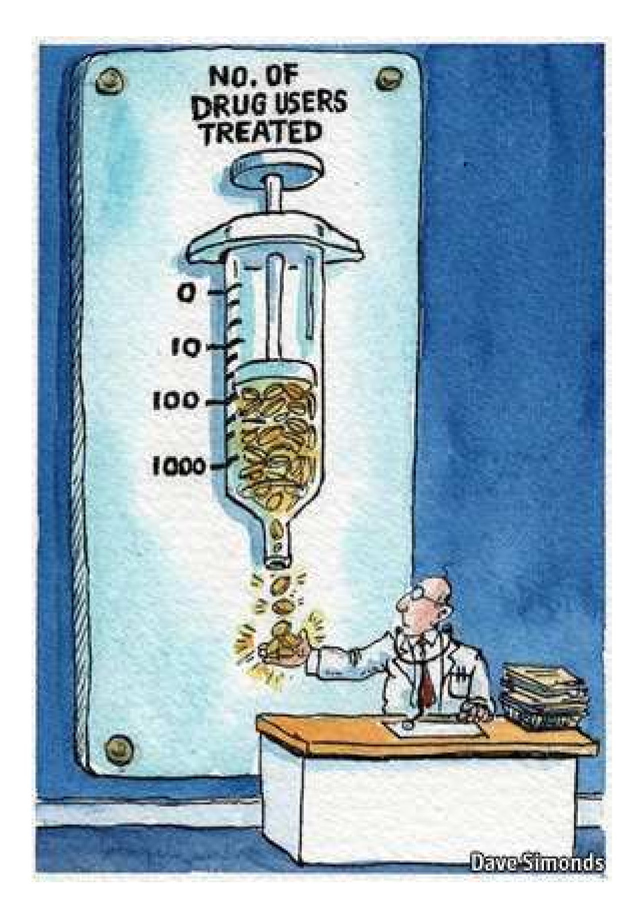
Bringing together lots of radio stations in a single online player should speed technological progress. Tim Davie, head of audio and music at the BBC, points out that Radioplayer sharpens competition not only over programming but also over search data and algorithms. Stations will compete to ensure that searches lead to their programmes (at the moment the BBC appears to be ahead in this respect). That ought to improve internet radio as a whole. Spotify, here they come.

Index | Britain

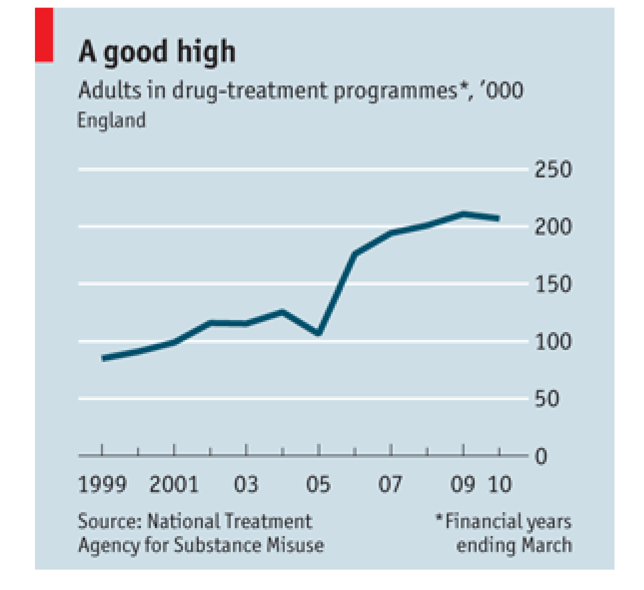
Treating drug dependence

New habits for old

The extension of "payment by results" to the treatment of drug addicts will test the method's limits



AT PHOENIX FUTURES in Birmingham, Karen is six weeks into a programme of group therapy sessions, life-skills training and one-on-one meetings with her keyworker, Dean. Things are looking pretty good. A former heroin user, she was on methadone for years before going into residential rehab last October. Karen now takes a relatively low dose of Subutex, a weaker heroin substitute, which she intends to come off altogether over the next six weeks. She credits her treatment with giving her the stability to have her three-year-old son to stay with her at weekends, and hopes to take a course or get a job-and eventually to work with drug users-once she is fully abstinent.



There are many Karens in Britain, though most are not doing as well as she is. Around 320,000 people are thought to be on heroin or crack cocaine or both in England alone. Many more use cannabis (the most popular drug), powder cocaine or a constantly changing clutch of designer drugs and legal highs: in all, almost 3m in England and Wales used some sort of illegal drug in 2009-10. A big push by the previous Labour government lifted the numbers in treatment (see chart), and drug use seems to be falling a bit now. But it remains high by European standards. Some argue that too many users have been "parked" on methadone rather than encouraged to kick chemical dependence altogether.

Intent on remedying what the Conservatives see as the persistent ills of "broken Britain", the Tory-led coalition government has big ambitions in drugs policy. It wants to get more people through treatment and functioning again-free of drugs if possible, but also employed, housed and law-abiding. There is a moral dimension to its emphasis on recovery rather than harm reduction, but also an economic one. Use of heroin or crack cocaine is linked to between a third and a half of all acquisitive crimes; an estimated 400,000 benefit claimants who are dependent on drugs or drink cost the Treasury pound1.6 billion a year; and demands on the health service and criminal-justice system are great. The coalition's commitment is real: at a time of screaming budget cuts, central-government funds for drug treatment in communities and prisons have barely been hit.

A key plank of the strategy is "payment by results". This approach to delivering public services-rewarding charities, community groups or private firms not for what they do but for how well they do it-has been seized on gratefully by a cash-strapped government. Versions are being tried to get welfare recipients into work and discourage criminal reoffending. Now eight drug-treatment pilots are to be launched. This breaks new ground internationally, says Martin Barnes, the head of DrugScope, a drug-information charity.

No magic wand

The theoretical argument for payment by results is that, by rewarding only success, it drives up standards while reducing costs. "It will make organisations focus on delivering quality services because they won't survive if they don't," says David Biddle, deputy chief executive of CRI, a charity whose drug and alcohol services have grown rapidly. Kent is one area chosen for a payment-by results pilot. "Commissioners will now have the opportunity to reward those who innovate, and deliver efficient and effective services," says Amanda Honey of Kent County Council.

Not everyone is sure that payment by results will work in drug treatment, however. Outcomes are hard to measure. In welfare-to-work schemes, a claimant either gets and holds a job or he doesn't. A prisoner is convicted of reoffending or he isn't. With drugs, progress often consists of baby steps on various fronts, which is why the government proposes to pay for a range of positive outcomes including jobs, housing and so forth. Coming up with precise measures is proving hard.

Setting tariffs is difficult, too. Payment by results works only if risk is transferred to the provider. But drug users are prone to relapses, and recovery can take years. Most not-for-profits in drug treatment are small; they need payment along the way to cover their costs. If instead they become subcontractors to larger outfits, a one-size-fits-all approach could replace the tailored solutions seen by many as a key to success. Whoever is contracted, "if the basic tariff isn't enough, it will wipe

out the chances of the provider doing anything good. If it's too much, then there is no risk transfer. If it's the wrong mix [of incentives], then it encourages gaming," says Lord Adebowale, the chief executive of Turning Point, a health and social-care organisation.

Despite the challenges, Turning Point and CRI are both interested in the trials. For its part, smaller Phoenix Futures has started offering a payment-by-results option off its own bat. "I wanted us to be ready," says Karen Biggs, its chief executive.

But other uncertainties loom, as more administrative power is pushed down from Whitehall. From 2013 the funds earmarked by central government for drug treatment in the community (currently about pound500m) will be handed over by Public Health England, a new bit of the NHS, to local authorities; drug and alcohol funding will merge, and perhaps disappear into the overall public-health pot. New elected police and crime commissioners will have a say in this area, as might local GPs newly charged with commissioning health care.

Anne Milton, the minister for public health, is determined that money will not leak away from drug treatment, counting on a national "outcomes framework" to make sure that needs which are not regarded as a priority locally continue to be met. Payment by results in this complicated and difficult area might prove transformative in all the right ways-or it might turn out an unholy mess. If it does work, says one sceptical charity, "they can use payment by results to deliver absolutely anything."

Index | Britain

Bagehot

A wasted vote

Both supporters and opponents of a new voting system are insulting the public's intelligence



BY TRADITION, British political leaders dislike referendums. A gift to demagogues, they grumble, and easily hijacked by irrelevant side arguments. Well, they should know.

On May 5th Britain will hold its first national referendum since 1975, to decide whether to change the voting system for general elections. National politicians and their proxies have barely tried to explain the question on the ballot to voters. Instead, the two sides have staged a mud-pie fight of spurious, partisan claims and counter-claims.

This could have been a chance to debate the sort of democracy the country wants. After all, the ballot offers a distinct political choice. Either keep the current model of first-past-the-post (FPTP), which provides ideological clarity but is not very representative (it offers nothing to parties with minority support in a given area, whether Labour in southern England, the Conservatives in Scotland, or Liberal Democrats, Greens and anti-Europeans all round the country). Or choose a new method, the alternative vote (AV). Though falling well short of a revolutionary leap to proportional representation, this would favour candidates who reach out beyond party lines, because winning under AV often relies on second-preference votes from defeated rivals.

The vote could have been a referendum on British views of competition versus compromise. The current voting system, for all its faults, implies a bracingly free-market, winner-takes-all view of the world: it is no surprise that famous folk endorsing the No to AV campaign are mostly entrepreneurs and sportsmen. In contrast, the AV system is closer to the consensual, corporatist worldview cherished on much of the European continent, in which ideological clarity (and thus accountability) is sacrificed on the altar of majority support. The Yes camp has been endorsed by numerous affable entertainers such as Colin Firth and Stephen Fry.

True, explaining the technical choice on offer is a fiddly business. In the seaside town of Lyme Regis this week, a "Fairer Votes for Dorset" event set out to sell AV to locals with stirring speeches and a mock double election for pizza toppings. Under FPTP, Lyme Regis was a two-way marginal between divisive rivals: Vegetarian Feast and Meat Feast. Then came an AV ballot. Watching from the back, near the tea urn and trestle-table piled with leaflets, Bagehot wondered if the AV demonstration had not misfired: after four rounds of counting, victory went to Meat Feast, presumably annoying quite a few in the room, starting with the vegetarians. The truly consensual option, Cheese and Tomato, was eliminated in the first round.

But the national campaigns have not attempted patient explanation, instead plumping for cartoonish exaggeration. A television broadcast by the Yes campaign shows MPs variously hiding from voters in their big houses, or arrogantly tucking into an expense-account lunch. It claimed AV would force MPs to "work harder" because they would all have to aim for majority support. That is a stretch. A study by the New Economics Foundation, a think-tank, estimates that AV would merely trim the number of safe seats, so that 16% rather than 13% of seats would change hands at a typical election. Furthermore-in contrast with the system used in Australian federal elections, in which all candidates must be ranked in order-the form of AV on offer in Britain would allow constituents to give their favourite a "1" and stop there, turning AV elections into a messy version of FPTP, and allowing candidates to win with a minority of votes cast.

If anything, the national No campaign-which is backed by the Conservative Party but also many Labour MPs-has aimed still lower. Billboard posters unveiled on April 13th urged Londoners to vote No to "Keep One Person One Vote". That is misleading. Under AV everyone gets the same ballot, but fringe-party supporters can cast, cost-free, a first preference protest vote, confident that their second preference has a good chance of affecting the result. The No camp's nastiest poster simply declares that elections under AV would be much more expensive, and shows a soldier in battledress with the slogan "He needs bulletproof vests NOT an alternative voting system. Say NO to spending pound250m on AV. Our country can't afford it." Given that all democratic elections cost money, this is a perilous argument to pursue very far (it cannot be a good sign that the same poster could be used, with minimal alteration, by the Qaddafi regime on the streets of Tripoli).

Talking past each other

The Yes and No camps bellow and roar about the marvellous or horrible consequences of AV. The ordinary voters Bagehot encountered this week on the campaign trail wanted to talk about something more down to earth: the public's experience of democracy, and whether AV might possibly improve it.

In west Dorset, an AV supporter, Rikey Austin, talked of yearning to cast a first preference for the Greens after years of tactically voting Lib Dem. Accosted by Yes canvassers in the Cambridgeshire village of Kimbolton, John Chadwick suspected AV would "not make a lot of difference", but hoped it might increase voter turnout by interesting those fed up

with the big three parties. In the Manchester suburb of Urmston, a No voter walking his spaniel said a winner should be the person with the most votes: ranking preferences felt like "hedging bets". (Still others admitted they knew nothing about AV, so would not vote.)

Nobody dares predict a result: the opinion polls are close and turnout risks being very low, especially in London where no other elections are being held on May 5th. One question has already been answered, however. Offered a chance to engage seriously with voters, Britain's political leaders rejected it. It seems that distrust between electors and the elected runs both ways.

Index | International

Conflict and poverty

The economics of violence

Are countries poor because they are violent or violent because they are poor?



YESTERDAY it was Afghanistan and Congo. Today it is Cote d'Ivoire and Libya. Violence, it seems, is always with us, like poverty. And that might seem all there is to be said: violence is bad, it is worse in poor countries and it makes them poorer.

But this year's World Development Report, the flagship publication of the World Bank, suggests there is a lot more to say. Violence, the authors argue, is not just one cause of poverty among many: it is becoming the primary cause. Countries that are prey to violence are often trapped in it. Those that are not are escaping poverty. This has profound implications both for poor countries trying to pull themselves together and for rich ones trying to help.

Many think that development is mainly hampered by what is known as a "poverty trap". Farmers do not buy fertiliser even though they know it will produce a better harvest. If there is no road, they reason, their bumper crop will just rot in the field. The way out of such a trap is to build a road. And if poor countries cannot build it themselves, rich donors should step in.

Yet the World Development Report suggests that the main constraint on development these days may not be a poverty trap but a violence trap. Peaceful countries are managing to escape poverty-which is becoming concentrated in countries riven by civil war, ethnic conflict and organised crime. Violence and bad government prevent them from escaping the trap.



To see the impact, compare two small African states. Until 1990 Burundi and Burkina Faso had similar rates of growth and levels of income (see chart). But in late 1993 civil war erupted in Burundi after the assassination of the president; 300,000 people died in the next dozen years, most of them civilians. Placid Burkina Faso is now two-and-a-half times richer.

That may sound like a special case. Civil wars are obviously damaging, and not many countries suffer them. True, but a lot of others are trapped in persistent, pervasive lawlessness. The report reckons that 1.5 billion people live in countries affected by political violence, organised crime, exceptionally high murder rates or low-intensity conflicts. All this falls short of civil war, but the effects can be as bad.

Many of these people are caught in cycles of violence. Almost all the 39 countries which have suffered civil wars since 2000 also had one in the previous three decades-something that was true of far fewer in the 1960s. Moreover, "lesser" forms of violence are worsening to a point where they can be more deadly than civil war itself. In Guatemala, more people are now being murdered each year (mostly by gangs) than were killed in the country's civil war in the 1980s (see article).

This is more remarkable because "traditional" state violence is subsiding. Although the world's population has expanded since 1990, numbers of interstate wars, civil wars and coups have fallen-as have the numbers of deaths in them. Fewer countries suffer large-scale violence, but the ones that do suffer repeatedly.

As a result, people in these countries are more than twice as likely to be malnourished, three times as likely to miss primary school and almost twice as likely to die in infancy as people in other developing countries. They are also more vulnerable to shocks. Protests during the 2007-08 food-price crisis were more frequent and more likely to turn violent in countries with the most fragile governments.

The gap between the two sets of countries is widening. Nearly all have cut infant mortality since 1990. But conflict-ridden states have reduced it by only 19% compared with 31% elsewhere. No poor, violent country has achieved a single one of the millennium development goals (MDGs), targets set by the UN in 2000. As a rule of thumb, concludes the report, countries that suffer large-scale violence lose almost 1% in poverty reduction each year.

But perhaps these countries are violent because they are poor, rather than poor because they are violent? To some extent this is true. As a rebel leader in South Sudan once said, life is so cheap "It pays to rebel". Growth would presumably reduce the incentive to fight. To test the importance of wealth, the authors of the report asked why young people joined gangs and rebel groups in half a dozen countries. The biggest share, about two-fifths, cited unemployment as the main reason; only a tenth said belief in the cause (in contrast, belief was cited as the main motivation half the time for members of militant Islamist groups in Mali and the West Bank).

But even if poverty is a cause of violence, it is not the only one. Legitimacy of government also matters. The report tries to disentangle its effects from income by looking at countries with similar incomes and identifying those that stand out for governance. It finds that countries with good governance are much less likely than their peers to have suffered from civil conflict or high murder rates in 2000-05. Perhaps unsurprisingly, Libya scores worse on indicators measuring government accountability and tribal loyalties than Egypt or Tunisia-which may help explain the course the Arab spring has taken there. The more personal a government, the harder it finds to change.

The implications of this analysis are wide-ranging. First, it suggests that preventing violence should be given much higher priority than it is now. At the moment, the MDGs that guide as well as measure development do not even mention things like justice and people's security.

Next, countries should learn from the mass of evidence about what works to reduce violence. Quickly restoring people's confidence in government is key. This can be done by getting a reasonable number of conflicting parties to sign up to a peace deal or otherwise break with the recent past, as Ghana did in 2003. Governments also need to signal good intentions straight away by making credible appointments (as Nigeria did in picking its new electoral commissioner). And they need some quick results, like new jobs. But, as the report says, "development assistance is easier to obtain for macroeconomic policy, health or education...than for job creation."

Third, outsiders should stop treating new conflicts as if they were traditional interstate or civil wars, with clearly defined roles for diplomats, soldiers and human-rights or aid workers. People need to act together, the report says-though most aid workers would not be seen dead working with a police or army officer.

Lastly, people need more patience-a lot more. It took the best-reforming countries since 1985 27 years to reduce corruption to acceptable levels. Few involved in post-conflict settlements are willing to wait that long. Haiti tried to create an effective government in 18 months. Naturally, it failed. The moral is that the countries of the Arab spring are likely to face multiple transitions, not just one. Alas, it is perhaps easier to urge patience if you are a World Bank economist than if you are the leader of an impatient or violent country under threat from your people or your rivals.

Index | International

Eyjafjallajokull one year on

The fire next time

Last year's volcanic-ash chaos in Europe is yielding lessons for the future



This is not an exercise

THE first anniversary of the eruption of Eyjafjallajokull, the volcano whose ash grounded most aircraft in Europe for days, was marked in a perfect way. On April 12th, almost a year later, a plume of ash rose 11 kilometres into the sky above Grimsvotn, another of Iceland's regularly erupting volcanoes. Airlines and air-traffic controllers across Europe quickly took note. Transfixed by images of the ash cloud on a new visualisation system created for the purpose since Eyjafjallajokull's eruption, they set up a "crisis cell" and sent out changes to flight plans.

These messages, though, were helpfully prefixed "Exercise Volcex 11/01 Exercise". Grimsvotn's eruption was a purely notional one, part of a two-day drill involving 70 or so airlines and other operators, a dozen air-traffic control systems and a variety of other bodies. In a similar exercise in 2008 only two airlines participated. But that was before last year's 100,000 flight cancellations, airline losses put at over euro1.3 billion (then $1.7 billion) and systemic knock-on effects on everyone from Kenyan farmers to Korean suppliers. Should another ash cloud rise to the skies, Europe will be better able to cope.

Last year's standstill came because some regulators of Europe's fragmented and highly congested airspace shut things down completely-mindful of advice that volcanic ash should always be avoided. One of the aims of Volcex 11/01 was to test a new approach to safety developed by the International Civil Aviation Organisation's task force on volcanic ash, set up last July. It would do away with blanket bans in favour of a more targeted way of dealing with the risk. National regulators would make decisions based on assessments by aircraft operators that took in flight plans, equipment and the ash's disposition.

Scientific preparedness is improving too. Britain's Met Office, which is responsible for advisories on risks to aircraft from Icelandic ash, predicts the movement of ash clouds with a model built after the Chernobyl disaster. It takes a weather-forecasting model of the atmosphere and injects particles of a specified mass and size at a particular place (the "source term"). Then it sees where the weather takes the particles. Many think simulations of the spread of Eyjafjallajokull's cloud put too much ash at the source. A new mobile radar stationed in Iceland should, says Ian Lisk of the Met Office, make the observations for the source term, now the largest source of error, more reliable. The Met Office also now has a "contingency aircraft" kitted out for ash studies that can gather data whenever it may be needed.

However good the source term, though, such models get further from reality as time goes on. Some cloud modellers are considering using the fact that ash, unlike fallout, can be seen from afar to make better calculations. Observations from ground, air and satellite of the ash's extent at specific times might be used to create a series of model runs that would track it better. Yet satellite coverage doesn't always allow for good snapshots; nor does the weather, which can put clouds in the way.

It is pleasing, if no more than proper, that Eyjafjallajokull should provoke new and even joined-up thinking from scientists, regulators and airlines. How much good this has done will be seen when Grimsvotn or another of Iceland's 130 volcanoes next puts some of the world's busiest airspace to the test-for real.

Retailing in India

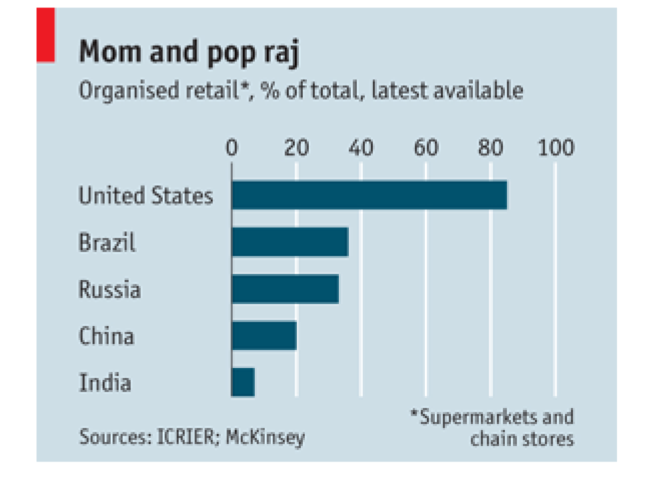
Send for the supermarketers

Opening up India's chaotic, underdeveloped retailing industry to foreign supermarket chains would bring many benefits



AT first sight the Easy Day store in Gurgaon on the outskirts of Delhi seems to be a supermarket like any in the developed world. On a sunny Saturday morning housewives and couples with children push their trolleys down the long, straight aisles, choosing from well-stocked shelves that offer Western brands such as Coca-Cola and Tropicana fruit juice as well as Thums Up and Real, two Indian counterparts. At lunchtime the shop suddenly empties. It is the day of the South Africa v India match in the cricket World Cup (which India later went on to win). Outside the shop a banner wishes the India team good luck.

For the managers of the Easy Day store chain, adapting their outlets to the plethora of local rules across the Indian subcontinent, the more than 20 officially recognised languages, 14 main types of cuisine, three main religions and countless religious and ethnic festivals in this most heterogeneous of countries-in which love of cricket is one of the few constants-is a piece of cake compared with the other challenges they face. India's "organised" retailers (ie, chains of stores, as opposed to independent, family-run shops) have to operate in the most supermarket-hostile environment among big economies in the world. The obstacles they are confronted with range from complex and sometimes nonsensical regulation to pot-holed roads, inadequate cold-storage facilities and sky-high prices for property.



No wonder then that a shop like Gurgaon's Easy Day is still a rarity in India. Chain stores account for only 7% of the country's $435 billion retailing business, a far lower proportion than in other countries, including India's BRIC peers (see chart). Most Indians do their shopping at the millions of *kirana* shops, small independent outfits that are often not much more than a hole in the wall, manned by the owner and maybe a relative, or from handcart hawkers and street vendors. These microbusinesses sell a limited range of goods, in tiny quantities. They are far too small to negotiate good deals with their wholesalers, who are themselves a pretty inefficient bunch. But the majority of Indians, especially in rural areas, shop with them-or send their servants to shop-because *kiranas* give them credit and are prepared to deliver even the smallest order to their homes. And because they often do not have any choice.

Indian policymakers have talked about reforming the retail business for the past two decades, with little to show for it. The most obvious, but most politically sensitive, reform would be to scrap the ban on foreign direct investment (FDI) by multi-brand supermarket chains such as America's Walmart and France's Carrefour. (Single-brand retailers such as Nike or Reebok can own a 51% stake in their Indian outlets and multi-brand retailers can open wholesale warehouses, as long as they do not sell directly to consumers.)

Ending the ban is fiercely opposed by the millions of *kirana* owners and their dependents, who are an important electoral constituency of the Hindu nationalist Bharatiya Janata Party. However, the party is not in power at the moment and the ruling Congress party did make encouraging noises by publishing a detailed discussion paper on the benefits of liberalisation last summer. It noted, for example, that heavy investment by big supermarket chains may be the best way to create an efficient "chill chain" in India, to keep food fresh from the farmer's field to the shopper's basket, and thus cut the terrible waste of food caused by the absence of such facilities: perhaps a quarter or more of fruit and vegetables is lost, compared with a tenth or less in countries with better cold storage and transport.

Just before the budget in February, the government published its annual Economic Survey, which proposed a gradual opening, letting foreigners start by setting up multi-brand stores in big cities. Yet the finance minister shot down the proposal, refusing to include it in his budget.

While the multinationals continue to wait for fuller access, Walmart is expanding its joint venture with Bharti, an Indian conglomerate, which provides wholesaling and logistics-including to Bharti's Easy Day chain. Walmart may be on the verge of forming another alliance, with Future Group, the Mumbai-based owner of Pantaloon Retail, though the behemoth from Bentonville refuses to confirm reports that the two firms are talking.

Doug McMillon, the chief executive of Walmart's international division, is tireless in arguing the case for opening Indian retailing to foreign supermarket firms. He says that Walmart would invest heavily in shops, create jobs, plough profits back into food-supply and cold-storage infrastructure and help to tame food inflation by keeping prices for staple foods low. He cites the example of Mexico, which allowed FDI in multi-brand retail in 1991 after a heated debate on whether the move would bankrupt small mom-and-pop shops. Twenty years and many giant superstores later, such small outlets still have about half of the country's retail market.

Given India's strong growth prospects, the chances are that the *kirana* shops would be able to hold on to an even higher share. Technopak, a consultancy, reckons that India's retail market will nearly double to an annual turnover of $850 billion

by 2020. Assuming a gradual liberalisation, about 20% of the market then will be controlled by organised retail, predicts Technopak, leaving 80% still in the hands of the microbusinesses.

Foreign supermarkets will not have an easy ride if India does lift the restrictions on their entry. Besides such things as the dreadful roads and expensive land, they will have to cope with the requirement in some states to buy from a central market rather than directly from farmers. Then there are the complexities of state taxation: often there are levies on moving goods out of, as well as into, a state, or even ones on moving them within a state.

A history of failure, and a success

Given these challenges it is not surprising that Indian entrepreneurs have had so little success in opening supermarket chains so far. Maybe the most spectacular failure was that of Subhiksha, a discount retailer. It began operations in 1997 and expanded to 1,600 stores thanks to the exuberance of its founder, who took on heaps of debt. It was closed in 2009 amid accusations of mismanagement and fraud.

The biggest success to date is the chain founded by Pantaloon Retail's Kishore Biyani. His company, which includes fashion shops and malls as well as supermarkets and hypermarkets, has stores in 73 cities, employs around 30,000 people and is two-and-a-half times the size of its nearest rival. Mr Biyani forecasts his group's revenue to be $4 billion next year and to increase to $20 billion by 2020. "Indians are learning to come to consumerism," says Mr Biyani, who, having grown up in a socialist economy, still feels some guilt when he goes shopping. His customers, on the other hand, are taking to choice and consumption like ducks to water. It is the politicians' mindset that needs to change.

Index | Business

Mining

Glencore comes to market

A hitherto secretive firm may be uncomfortable under the spotlight

EVEN sky-high prices have done little to inject much in the way of mystique or glamour into the dull world of commodities. The forthcoming initial public offering (IPO) of Glencore promises to achieve this apparently impossible task. After months of hints from the firm and excited rumour-mongering among financial types, on April 14th the Swiss-based company at last said that it planned to list up to 20% of its shares in London and Hong Kong. The IPO will raise as much as $11 billion, making it one of the biggest on record.

The excitement surrounding Glencore has much to do with the cash that the company's 485 partners will earn (on paper, at least) from going public. Estimates put the average payout at $100m. Ivan Glasenberg, the firm's boss, and a handful of top managers are set to join the billionaires' club. But lock-ins will reassure investors that the firm's brainpower will stick around.

Glencore's aura is unlike that of any other miner or trader in that it has one at all. Global dealing in metals, agriculture and oil, and a well-earned reputation for being on the right side of most trades, mean that it is regarded with a mixture of envy and awe by competitors. Mutterings that Glencore's combination of success and secrecy must mean it has something to hide are probably just sour grapes from those who have been on the wrong end of a trade with it.

Even so, a firm that has hitherto kept a low profile will have to get accustomed to revealing a fair amount about its activities. One question that the IPO will answer is how much the company is worth. A convertible bond issued in December 2009 valued it at $35 billion. But since then China's ravenous appetite for raw materials has pushed commodity prices ever higher, boosting the value of Glencore's mining interests-including the giant Prodeco coal mine in Colombia (pictured below)-and its agricultural assets, which range from farms to grain-storage facilities.



A mucky business but a profitable one

Its biggest investment is a 34.5% stake in Xstrata, a diversified miner that was created by spinning off Glencore's former coal-mining assets a decade ago, which is worth around $24 billion. It also owns 8.8% of RUSAL of Russia, the world's biggest aluminium producer. These are far easier to value than Glencore's trading business. No competitor has the same global reach or trades as many different commodities, which makes comparisons difficult. Most recent estimates put a value of about $60 billion on the whole of Glencore, which made profits of $3.8 billion in 2010 on revenues of $145 billion.

Debate centres on whether the firm's marriage of trading and mining should attract a discount or a premium. Glencore would argue the latter. Intelligence gathered by its trading operation's 50 offices worldwide helps it negotiate the best prices for the commodities it trades, but also helps it to spot investment opportunities. On occasion Glencore has taken stakes in firms that have run into difficulties, or has otherwise spotted opportunities and struck deals, before rival mining firms got to hear about them.

Doubters think such advantages amount to rather less than Glencore would have them believe: they see little synergy between the boffinry required to run a successful trading business and the dogged cost-control needed to profit from mining. Whichever is right, Glencore's IPO will give it the currency to continue expanding in both sides of the company.

The most obvious investment it might make is to buy out the other shareholders in Xstrata, probably through a share swap. It already refers to Xstrata as a "sister company" and regards an eventual merger as a foregone conclusion. Once the IPO establishes a value for Glencore's shares, it will be much easier to convince Xstrata's other investors to swap. Yet Xstrata's bosses reckon that their firm has more to offer Glencore than vice versa. It has a balanced set of assets and a clear strategy for strong organic growth. Glencore's own mining interests, although they include some gems, are a bit of a mixed bag.

A combined Glencore and Xstrata would have the resources to take on mining titans such as Rio Tinto and BHP Billiton, as well as the state-backed giants from China and India. But it will find that the market for the biggest deals is more crowded than that for the medium-sized prospects it is more used to dealing with. It may miss being a big fish in a smaller pond.

Under the spotlight

A bigger question is how Glencore's management will cope with unaccustomed public scrutiny and the demands of quarterly financial reporting. Mr Glasenberg, refreshingly blunt in private yet hitherto shy of public speaking, will need to adapt his style once he is expected to issue comments, and has them measured by the standards of a listed company's chief.

There is a risk that such trials may distract Mr Glasenberg from the assiduous micromanaging that has underpinned Glencore's success. The firm's quest to join the mega-miners may end up making it more pedestrian and conservative, blunting the ferocious competitive instincts that have served it so well.

Index | Business

Chinese business

When fund-raising is a crime

A death sentence for a young businesswoman chills entrepreneurs



IN THE odd way these things work in China, word has trickled out that on April 7th an appeal court in Zhejiang, a famously entrepreneurial coastal province, conducted a five-hour hearing on a death sentence handed down to Wu Ying, a prominent 29-year-old businesswoman, on fraud charges. Before her arrest Ms Wu had seemed to personify the miraculous business success that could be achieved by people from even the most humble background in modern China.

The revelation that she faces execution is the latest in a string of dramatic events surrounding her case, including the arrest of several prominent bankers and officials from information she is said to have given, and her own reported suicide attempt. Details are murky because much of the case, including the appeal, has taken place behind closed doors, with restrictions on direct press coverage. That, however, has not stopped Chinese newspapers and internet opiners from discussing avidly a case that has clearly caught the public interest.

If any point is beyond dispute, it is that Ms Wu was a dynamo. She dropped out of secondary school and started a string of beauty parlours whose primary product was the use of animal-placenta injections to achieve the same sort of skin-smoothing effect for which collagen is used in the West. Within a few years she was reported in *China Daily* to have

assembled a business empire that spanned spas, hotels and property. Her net worth was then said to exceed 3.8 billion yuan ($576m).

It all began to crumble when Ms Wu was detained in 2007, but a conviction did not come until December 2009, a particularly long delay that many believed was caused by efforts to broaden the investigation to include other prominent people. Ultimately, she was convicted of "illegal fund-raising" for, the court concluded, raising 773m yuan from illicit sources. In an effort to mitigate her sentence, in the appeal Ms Wu changed her plea from innocent to guilty of "fund-raising fraud", a lesser charge. Since her initial trial three other people have received long jail sentences in related cases, two of whom had ties to the vast Agricultural Bank of China and one to the Communist Party.

The case struck a nerve across the country, and not just because of the severity of the sentence and the fame of the accused. What she was convicted of was raising and pooling money outside the official system, which is common among Chinese entrepreneurs. There has been much speculation about why she was singled out. Perhaps it was that her promises to investors of annual returns of up to 80% seemed just too good, to the authorities, to be genuine. It is also possible that she lent on the money she received at even higher rates, and the borrowers, unable to pay, used their political connections to have her arrested.

China's entrepreneurs are left with plenty to worry about. Many have to rely on a form of financing that now seems to be interpreted by the courts as a grave crime. The distinction between being a successful tycoon and being an enemy of the people has been blurred, a step back to the days when China was communist in more than just name.

Solar power

Desert dawn

Some solar plants need to be big; most of them don't



Soaking up the sun on a vast scale at Ivanpah

IT LOOKS like a planetary tattoo designed to be seen from space, a vast set of concentric circles inscribed in the skin of southern California's desert. Ground was broken on the Ivanpah power plant, which is to be one of the biggest solar installations in the world, last October. Already, some of the rings of mirrors which will eventually concentrate acres-worth of desert sunshine on to collectors perched atop 140-metre-high towers are in place. And as of this week, so is the financing.

BrightSource, based in Oakland, California, announced on April 11th that it had finalised $1.6 billion in loans for Ivanpah from America's government. At the same time it announced that Google had taken a $168m stake in the project.

Ivanpah needs all this money because BrightSource's technology requires it to be vast compared with other types of solar installation. Most solar power comes from photovoltaic cells that turn sunlight directly into electricity: installations of this type can be any size. BrightSource's system, like other "solar thermal" technologies, concentrates the sun's heat to drive turbines; and the high-performance steam turbines it relies on are big. The three to be installed at Ivanpah will together have a greater capacity than all the "utility scale" photovoltaic plants yet built in America.

It was once thought that photovoltaic installations might attain a similar size as they spread across America's West (a prospect viewed with alarm by some environmentalists). There are now indications that this won't happen. Nathaniel Bullard of Bloomberg New Energy Finance has been looking at photovoltaic projects registered with California ISO, the state's grid operator, since 2007. Their median size started off close to 100MW; now it is around 20MW. Not all these projects will be completed-but it seems a reasonable assumption that bigger ones may be more likely to fall by the wayside. If so, the average size will drop even more dramatically.

Mr Bullard thinks the photovoltaic business is learning that small, if not exactly beautiful, is easier to get past environmental controls and planning consents, and handier if you want to feed into existing grids. "Brownfield" industrial sites near towns beat desert skies.

This is not to say that big photovoltaic projects are finished. The day after the Department of Energy bestowed its beneficence on Ivanpah, it offered a conditional loan of $1.2 billion to SunPower, a maker of high-efficiency photovoltaic cells, for a 250MW project, the California Valley Solar Ranch near San Luis Obispo. SunPower will build and operate the plant; NRG Solar, a subsidiary of NRG Energy of New Jersey, will own it. (NRG Solar is also investing up to $300m in Ivanpah.)

Such big projects make sense for large solar-cell producers like SunPower and Arizona-based First Solar, since they provide reliable demand with which to keep their manufacturing plants running at peak efficiency. Tom Werner, SunPower's chief executive, says that although the Solar Ranch project is "on the large side", there is a role for photovoltaic plants of all sizes, and his company has plenty more of similar scale in the pipeline. As experience grows, he hopes to find banks, rather than governments, to finance them.

Whereas being extremely big remains optional for photovoltaics, for thermal-solar companies such as BrightSource it is a must. BrightSource hopes that in time its technology will prove sufficiently efficient and reliable to overcome the disadvantage of having to raise so much capital. If so, Ivanpah will be the ground on which it makes its case.

Index | Business

Italian industry

Clusters flustered

Global competition seems to be weakening the benefits of being in a cluster

OPENED in 1845, the Cantoni cotton mill in Castellanza went on to become the country's biggest but, burdened by debt, it closed in 1985. A large cluster of producers centred on the town, once called the Manchester of Italy, also perished. In Como, about 20 miles (32km) to the north-east, a cluster of silk firms is ailing, and so is a woollens cluster around Biella, 50 miles to the west, victims like Castellanza of low-cost competition.

Michael Porter, a guru on clusters at Harvard Business School, has said they help productivity, boost innovation and encourage new firms. For Mr Porter, firms' geographical proximity, their close competition with each other and the growth of specialised suppliers and production networks around them make a winning combination. Globalisation has, however, made this far less certain. More open trade and improved transport links may mean that bunching together in a cluster no longer offers such a strong defence against cheaper foreign rivals. Indeed, as Italy's medium-sized industrial firms adapt to the threat from China, the benefit they get from being bunched together in a cluster seems to be weakening.

More than 100 such clusters speckle the boot of Italy: tiles in Sassuolo, food machinery in Parma, sofas in Matera, footwear in Fermo and clothing in Treviso, to name just some. A few owe their existence to local natural assets-marble is quarried in the mountains behind Carrara, for example. But mostly they are the result of skills built up over successive generations. The packaging-machinery firms around Bologna grew out of the region's tradition of precision engineering, and the area around Belluno, where the first ever spectacles factory was built in 1878, is still home to a cluster of eyewear makers.

San Maurizio d'Opaglio, midway between Castellanza and Biella, is the world's largest centre for working brass. Workers there once made bells; now the cluster has around 380 firms that together employ about 10,000 people making valves and taps, businesses that took off with reconstruction after the second world war and the building boom that followed. About 19,000 are employed in small satellite firms involved in parts of the production process.

Founded in 1951, now employing 850 people who make brass valves, connectors and manifolds and turning over euro165m ($218m) last year, Giacomini is a giant of the cluster. However, quality certification, precision production and a catalogue of 6,000 products will not safeguard its future. "Germans saw us in the 1950s and 1960s as we now see Chinese products-low quality, low cost. Long-term, brass fittings are not enough. We cannot expect to survive on these," admits Corrado Giacomini, the chairman. The firm began diversifying into electronic controls and heating and air conditioning systems ten years ago, and this move away from its traditional business means that its links to the cluster look increasingly less relevant to its future.

Zucchetti, a tapmaker in the nearby town of Gozzano, has also changed strategy. As well as buying a maker of luxury baths and basins, it has shifted production upmarket, with smaller production runs and a larger product range. How Zucchetti performs in the future depends less on being in the cluster than designing smart products and defending its brand. A recent report from Intesa Sanpaolo, a bank, notes how competition is forcing firms to innovate, improve quality and build brands.

Firms in a jewellery cluster in Valenza, in southern Piedmont, hope to protect their businesses with help from the regional authorities, the creation of a group trade mark and peer pressure to keep skills in the cluster. Bruno Guarona, chairman of the jewellers' association, moans about unfair competition from China, where labour regulations are lax and firms enjoy tariffs and duties that undercut those his members face. But he reserves special bitterness for jewellers from Valenza who have moved production abroad, "traitors who have committed a crime".

Indeed, fragmentation of production and outsourcing abroad, clear signs that firms have become less competitive, weaken the networks on which clusters are built and may even destroy their competitive advantage, warns Rodolfo Helg, an economics professor at the university in Castellanza, which occupies the buildings that were once the town's large cotton mill. He believes successful clusters in the future will be very different from those of the past. Britain's large manufacturing clusters withered and died. The risk for Italy is that the decline of its clusters will prove as terminal elsewhere as it was in Castellanza.

Index | Business

Friends and enemies

As one legal battle over Facebook fades, another moves forward



Not a good day for the Winklevi

JUST when it looked as though the fuss over Facebook's early days might be about to die down, the long-running legal soap opera over the rightful ownership of the online social network has sprung another surprise. On April 11th Paul Ceglia-who last year filed a lawsuit claiming entitlement to half of the stake held by Mark Zuckerberg, Facebook's youthful co-founder-submitted an amended complaint complete with e-mails that he claimed would support his case for a share in the company.

Mr Ceglia's bombshell was dropped on the same day that Facebook's boss received some better news. A panel of federal appeal-court judges in San Francisco handed down a decision that probably scuppers another legal challenge over his company's ownership. The judges threw out a petition by two of Mr Zuckerberg's contemporaries at Harvard University, Cameron and Tyler Winklevoss-twins dubbed "the Winklevi" by their fellow students-seeking to scrap a settlement they had reached with Facebook in 2008. In that settlement, reportedly worth $65m, the Winklevosses and Divya Narendra, another former Harvard student, had dropped their claim that Mr Zuckerberg stole their idea for a social-networking service.

Since then the value of Facebook has soared (it is now said to be worth up to $60 billion), which may have prompted the Winklevosses to try to get the settlement scrapped so they could fight for more generous terms. But the judges rejected their argument that they had been misled about the true value of Facebook when the deal was signed. "The Winklevosses are not the first parties bested by a competitor who then seek to gain through litigation what they were unable to achieve in the marketplace," wrote one judge. "At some point litigation must come to an end," he added. "That point has now been reached." The Winklevosses' lawyer indicated that they might nevertheless fight on.

Mr Ceglia, meanwhile, has engaged DLA Piper, a big law firm, to represent him over his claim that a contract he allegedly signed with Mr Zuckerberg in 2003 entitles him to a share in the firm. The deal supposedly involved Mr Ceglia giving Mr Zuckerberg $1,000 to develop the website, and a further $1,000 for work on another project, in return for a substantial chunk of any future business.

Lawyers for Mr Zuckerberg and Facebook dismiss Mr Ceglia's claim, arguing that the e-mails he has produced to support it are fakes. Some of these purportedly show Mr Zuckerberg discussing the site's development with Mr Ceglia and giving warning of a potential rival service being developed by nameless fellow students (presumably the Winklevosses and Mr Narendra). The courts will need to be convinced not just of the e-mails' authenticity but of Mr Ceglia's explanations for why he waited seven years before coming forward to stake his claim.

Index | Business

Schumpeter

Fail often, fail well

Companies have a great deal to learn from failure-provided they manage it successfully



Brett Ryder

BUSINESS writers have always worshipped at the altar of success. Tom Peters turned himself into a superstar with "In Search of Excellence". Stephen Covey has sold more than 15m copies of "The 7 Habits of Highly Effective People". Malcolm Gladwell cleverly subtitled his third book, "Outliers", "The Story of Success". This success-fetish makes the latest management fashion all the more remarkable. The April issue of the *Harvard Business Review* is devoted to failure, featuring among other contributors A.G. Lafley, a successful ex-boss of Procter & Gamble (P&G), proclaiming that "we learn much more from failure than we do from success." The current British edition of *Wired* magazine has "Fail! Fast. Then succeed. What European business needs to learn from Silicon Valley" on its cover. IDEO, a consultancy, has coined the slogan "Fail often in order to succeed sooner".

There are good reasons for the failure fashion. Success and failure are not polar opposites: you often need to endure the second to enjoy the first. Failure can indeed be a better teacher than success. It can also be a sign of creativity. The best way to avoid short-term failure is to keep churning out the same old products, though in the long term this may spell your doom. Businesses cannot invent the future-their own future-without taking risks.

Entrepreneurs have always understood this. Thomas Edison performed 9,000 experiments before coming up with a successful version of the light bulb. Students of entrepreneurship talk about the J-curve of returns: the failures come early and often and the successes take time. America has proved to be more entrepreneurial than Europe in large part because it

has embraced a culture of "failing forward" as a common tech-industry phrase puts it: in Germany bankruptcy can end your business career whereas in Silicon Valley it is almost a badge of honour.

A more tolerant attitude to failure can also help companies to avoid destruction. When Alan Mulally became boss of an ailing Ford Motor Company in 2006 one of the first things he did was demand that his executives own up to their failures. He asked managers to colour-code their progress reports-ranging from green for good to red for trouble. At one early meeting he expressed astonishment at being confronted by a sea of green, even though the company had lost several billion dollars in the previous year. Ford's recovery began only when he got his managers to admit that things weren't entirely green.

Failure is also becoming more common. John Hagel, of Deloitte's Centre for the Edge (which advises bosses on technology), calculates that the average time a company spends in the S&P 500 index has declined from 75 years in 1937 to about 15 years today. Up to 90% of new businesses fail shortly after being founded. Venture-capital firms are lucky if 20% of their investments pay off. Pharmaceutical companies research hundreds of molecular groups before coming up with a marketable drug. Less than 2% of films account for 80% of box-office returns.

But simply "embracing" failure would be as silly as ignoring it. Companies need to learn how to manage it. Amy Edmondson of Harvard Business School argues that the first thing they must do is distinguish between productive and unproductive failures. There is nothing to be gained from tolerating defects on the production line or mistakes in the operating theatre.

This might sound like an obvious distinction. But it is one that some of the best minds in business have failed to make. James McNerney, a former boss of 3M, a manufacturer, damaged the company's innovation engine by trying to apply six-sigma principles (which are intended to reduce errors on production lines) to the entire company, including the research laboratories. It is only a matter of time before a boss, hypnotised by all the current talk of "rampant experimentation", makes the opposite mistake.

Companies must also recognise the virtues of failing small and failing fast. Peter Sims likens this to placing "Little Bets", in a new book of that title. Chris Rock, one of the world's most successful comedians, tries out his ideas in small venues, often bombing and always junking more material than he saves. Jeff Bezos, the boss of Amazon, compares his company's strategy to planting seeds, or "going down blind alleys". One of those blind alleys, letting small shops sell books on the company's website, now accounts for a third of its sales.

Damage limitation

Placing small bets is one of several ways that companies can limit the downside of failure. Mr Sims emphasises the importance of testing ideas on consumers using rough-and-ready prototypes: they will be more willing to give honest opinions on something that is clearly an early-stage mock-up than on something that looks like the finished product. Chris Zook, of Bain & Company, a consultancy, urges companies to keep potential failures close to their core business-perhaps by introducing existing products into new markets or new products into familiar markets. Rita Gunther McGrath of Columbia Business School suggests that companies should guard against "confirmation bias" by giving one team member the job of looking for flaws.

But there is no point in failing fast if you fail to learn from your mistakes. Companies are trying hard to get better at this. India's Tata group awards an annual prize for the best failed idea. Intuit, in software, and Eli Lilly, in pharmaceuticals, have both taken to holding "failure parties". P&G encourages employees to talk about their failures as well as their successes during performance reviews. But the higher up in the company, the bigger the egos and the greater the reluctance to admit to really big failings rather than minor ones. Bosses should remember how often failure paves the way for success: Henry Ford got nowhere with his first two attempts to start a car company, but that did not stop him.

Economist.com/blogs/schumpeter

Gulliver's travels

HSBC's new boss must save a great firm from mediocrity



PARADISE for HSBC, the world's third-biggest bank by market value, can be found at Juhu Beach, a suburb in north Mumbai favoured by Bollywood stars. After negotiating a security guard snoozing on a plastic chair, you climb some grotty stairs past a placard begging, "Choose RBS business banking for your leather business." Inside is one of the two dozen or so branches that Royal Bank of Scotland, a bailed-out firm in retreat, is selling to HSBC, which is one of the biggest foreign banks in India. Its annual pre-tax profits there are approaching $1 billion.

Despite the entrance, the branch has potential. A lone customer is well-heeled and probably lives in one of the apartment blocks nearby, which are full of the sort of affluent folk that HSBC targets. Mumbai's commercial centre of gravity is shifting north, which should mean more business clients to plug into HSBC's global network. The staff are bright and keen. Run properly the branch could be a gem. And HSBC can run branches properly. Its existing outlet in Juhu, a few blocks away, is smart and busy.

Although HSBC has huge operations in America, Britain and France, it thinks of itself as an emerging-market specialist, with a tradition stretching back to its foundation in Hong Kong in 1865. And by its own legend it is also the bank that keeps its head when all about it others lose theirs. It is the quiet predator that grows by buying all or parts of those firms that are stupid enough, or too clever-by-half enough, to fail. For almost a century and a half, HSBC's strongest beliefs have not been in a product, person or geography, but in its own culture and in the folly of its rivals.



The legend no longer fits reality, though. The past five years should have been glorious for HSBC: there should have been lots of deals like the RBS India one (which awaits regulatory approval). Instead it is one of only three piddling acquisitions made in emerging markets since the financial crisis began in 2007. By contrast, other top banks, including JPMorgan Chase and BNP Paribas, have made big strides in their key markets. Furthermore, HSBC has lost market share in many countries, mainly to thriving local firms (see chart 1). One explanation for the bank's passivity is that some failed rivals, such as Citigroup, were bailed out rather than dismembered and forced to sell their crown jewels. But the lack of activity also reflects HSBC's losses in America, which weakened its balance-sheet, and a simple loss of nerve.

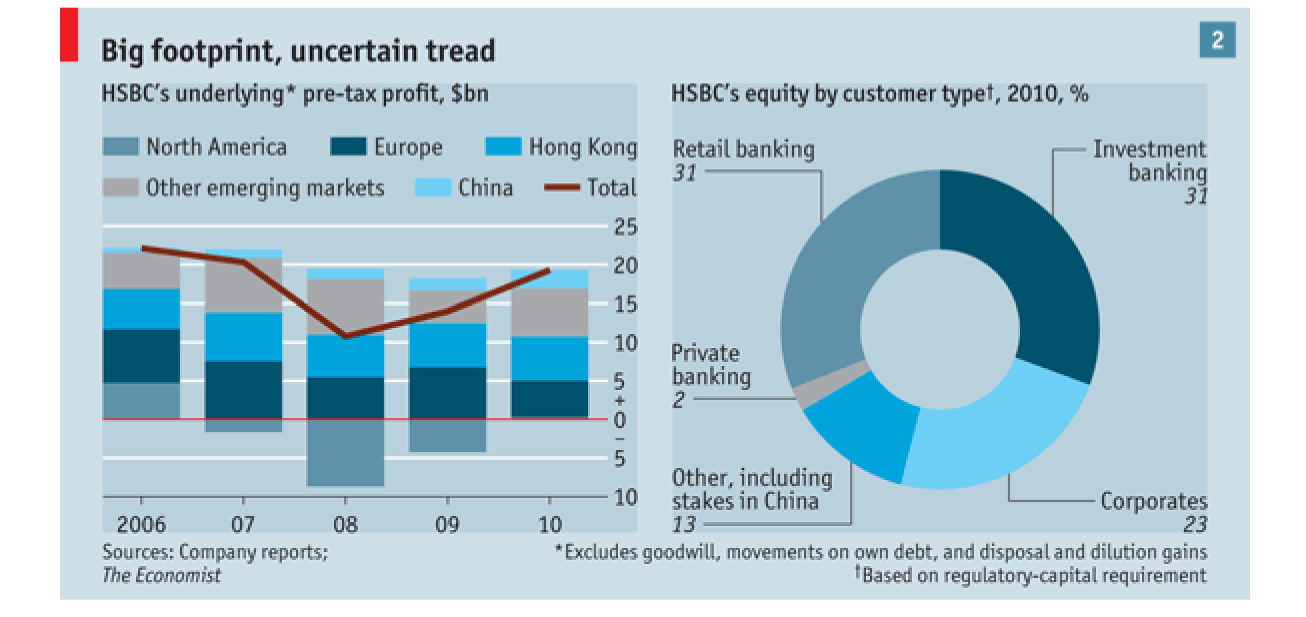
HSBC had a relatively good financial crisis. It did not need a bail-out. It enjoys a reputation for transparency and commanded enough investor loyalty to conduct a giant rights issue during the crisis and swat off criticisms from an activist fund, Knight Vinke. But opportunities missed in emerging markets have dimmed HSBC's aura. Like its adverts found in airports around the world, in which a single photograph is accompanied by two contrary captions, a firm esteemed by insiders is often slammed by its competitors. Citigroup bigwigs claim HSBC has still not joined up its operations in Asia. Local Indian rivals say the firm is nothing special. British competitors say its position there has slipped. Brazilian financial chiefs are known to tap their temples and say that HSBC is, in their considered view, nuts.

HSBC is not a mediocre firm in crisis. It is a great one slipping towards mediocrity. Its new targets, reset in February, appear confident. At their lower end they suggest the firm should aim to make a return on equity of about 14%. This is decent and roughly in line with the goals of JPMorgan Chase (these calculations use tangible equity for both firms, assume the tougher incoming "Basel 3" capital rules are already in place, and presume that both firms run with a 10% core capital ratio).

Yet HSBC starts from a weaker position. By the same measure it made a return of just 8.6% last year, compared with JPMorgan's 10.3%. Higher interest rates and lower bad debts will boost HSBC's profits. But regulatory headwinds are becoming stronger, particularly in Britain. This week the Vickers commission, a body of wise men set up by the British government, proposed new measures that will dent returns (see article).

Everywhere and nowhere

It would be nice if today's lacklustre results reflected difficulties just in America, where HSBC is winding up the consumer-lending business it bought in 2003. Underlying losses there have wiped out one-fifth of the rest of the group's profits over the past four years (see chart 2). But the broader picture is also disappointing. HSBC makes fantastic returns in Hong Kong, lousy ones in America and mediocre ones elsewhere.



An analysis by *The Economist*, based on a new breakdown by HSBC of its regulatory capital by geography and division, reveals the problem. (These calculations use underlying profits, assume a core capital ratio of 10% and the existing, softer, "Basel 2" rules, and remove from the picture HSBC's minority stakes in Chinese firms, which it does not run).

By this measure, an estimated 42% of the equity in operations run directly by HSBC made a return last year below the bank's cost of capital, which it reckons is 11%. About half of this idle equity sat outside America. There was considerable weakness in Latin America as well as pockets of sogginess in the Middle East, Europe and Asia. Several other parts of the firm-European investment banking in particular-only just made the grade. Set the bar higher, at HSBC's target return of 14%, and 63% of the group underperforms. These figures do not reflect the incoming, tougher, "Basel 3" rules, which will make things look worse.

The man who must tackle all this is Stuart Gulliver, who became chief executive at the start of the year, after a messy succession in which Douglas Flint, the firm's long-standing finance director, also became chairman. (Mr Gulliver refused to be interviewed for this article, citing an upcoming strategy presentation to investors. Two directors of The Economist Newspaper are also directors of HSBC; they were not approached for this article.) Mr Gulliver is a former star trader who has been loyal to the bank for 31 years. Although preoccupied with profits, he exudes pride when he speaks of the honour of running HSBC. Mr Gulliver also personifies the firm's double identity as a bank that is both British and Asian. He has an official residence in Hong Kong, spends much of his time on the road and pays tax in Britain.

In an interview with *The Economist* in 2010, before he was appointed boss, Mr Gulliver offered the company's past as a guide to its present and future. HSBC's history is certainly remarkable. It is one of only two mega-banks that have remained independent for more than a century, avoiding a bail-out or state control (the other is Santander of Spain). HSBC has endured despite, or perhaps because of, a turbulent environment. For most of the bank's history Hong Kong lacked a central bank or a state safety net. HSBC has witnessed a Japanese invasion, revolution in China (where it once made over a quarter of its profits), the demise of sterling and silver (in which its reserves were once held), the post-war wave of Asian economic nationalism, numerous bank runs, the move of the firm's domicile and headquarters from Hong Kong to London in 1993 and the territory's return to China in 1997.

But a glorious history often seems to impede clear thinking at HSBC. Romantics say that the bank used to prosper by deliberately not having any strategy at all. It just sat making money in Hong Kong, waited for the world to blow up, then picked up the pieces. This isn't accurate: three of the firm's four big, successful acquisitions between the 1949 revolution and 1992 were chewed over for years.

Still pining for the East

Institutional memories of the glorious Hong Kong years also help to explain the bank's ambivalent attitude to Britain. A traditional HSBC man walks, talks and drinks like a Brit-or, better, a Scot-and likes the City of London. But in his heart he suspects Britain is full of intellectually vain officials and is doomed to stodgy decline.

The prospect of a move of headquarters back to Hong Kong grew when Michael Geoghegan, Mr Gulliver's fiery predecessor, shifted his personal office there early last year in what now looks like an expression of frustration. As British regulators have become more hostile HSBC has dropped more hints about a move. One retired bigwig believes the threat is hollow. The logistics of moving are more daunting than when HSBC moved in the other direction in 1993. Two-thirds of the firm's 280 highest-paid employees are in Britain, at least half of its directors are based there and in the past two years about a quarter of recruits for its elite corps of international managers were British.

A senior Hong Kong official speaking to *The Economist* in November dismissed the idea of an imminent move, and his spokesman recently confirmed his view had not changed. A move by HSBC would make more sense if it yielded more lenient supervision and the opportunity to turn the bank's leading position in Hong Kong into a really powerful one in China. The first is possible-a lead regulator in Hong Kong might not demand the group-wide capital surcharge that Britain will. And a Hong Kong-based HSBC could try to shift activity away from subsidiaries facing unfriendly local regulators-such as investment banking in London. Yet this would be a daunting undertaking.

A great leap in China is no easier. HSBC has played its hand on the mainland better than any other foreign bank. It has the largest branch network, with 162 outlets. And it has an array of stakes in Chinese financial firms worth a hefty $27 billion at the end of 2010; the capital gain on and profits from these have partly offset the debacle in America. Its key holding is 19% in Bank of Communications (BoCom), China's fifth-biggest lender. HSBC does not have much sway over BoCom, but the agreement struck in 2004, uniquely among Western deals with Chinese banks, envisioned that the stake could rise to 40%, which would give it influence or control.

Yet the investment climate in China has changed. The boss of one of China's big state banks says that no foreign firm will be allowed a significant direct market share in China (foreign banks' share of the system's assets is only 2%). The state now classifies BoCom as one of five major banks, a label that signals it is not for sale. Few think HSBC will get control unless there is a banking crisis in China that prompts a change in the official line. That fits the mantra jokingly muttered by HSBC types since the deal was struck: "We'll have BoCom in the end, but it'll go bust first."

Mr Gulliver is well known in China and Douglas Flint recently met Wang Qishan, a vice-premier and an outside contender for the Chinese premiership, in a ceremonial engagement that seemed to reflect the bank's special stature in the country. HSBC continues to lobby for a listing of its shares in Shanghai. Absent a crisis, though, the suspicion remains that the price of full admission to China would be not just a return of the firm's headquarters to Hong Kong but a "Sinofication" of its executive ranks and the imposition of some state control. That would be cultural suicide for HSBC's current, largely Western, top brass. And the perception that the firm was under China's thumb might damage its business elsewhere.

Don't call me picky 3

HSBC's major acquisitions

Target firm *(% acquired*)*	Country	Year
Chartered Mercantile Bank of India	Britain	1959
British Bank of the Middle East	Britain	1959
Hang Seng Bank	Hong Kong	1965
Saudi British Bank *(40%)*	Saudi Arabia	1978
Marine Midland Bank	United States	1980
Midland Bank	Britain	1992
Banco Bamerindus	Brazil	1997
Banco Roberts	Argentina	1997
Republic New York	United States	1999
Crédit Commercial de France	France	2000
Demirbank	Turkey	2001
Grupo Financiero Bital	Mexico	2002
Ping An Insurance *(10%†)*	China	2002
Household Finance	United States	2003
Bank of Communications *(20%‡)*	China	2004
Bank of Bermuda	Bermuda	2004
Grupo Banistmo	Panama	2006

Source: Company reports

*If a minority stake
Current holding: †16% ‡19%

Nostalgia for the East has perhaps prevented HSBC from taking stock of the pile of other acquisitions since 1993 in places like France, Brazil, Mexico, Argentina, New York state and Turkey (see table 3). Veterans argue that the bank has picked up some bargains over the years. But successful expansions are about coherence as well as price. Before 1993 HSBC often left purchases to run themselves. Today, thanks in large part to the acquisition splurge, it is a federation present in 87 countries, often through subsidiaries with their own governance structures. They typically have local market shares of below 5%.

The idea of a "network bank" with a light presence in many countries is not, in itself, foolish. Such a bank can finance trade, organise transactions for multinational companies and sell common products to an increasingly homogeneous global middle class. But running a network bank is complex and expensive. After decades of drift, Standard Chartered, a largely Asian outfit headquartered in London, has begun to thrive, mainly by tilting more towards investment banking. Citi, by contrast, has had a terrible decade. Having lost money in investment banking, it is slimming down and hoping that its presence in lots of countries will be an advantage.

HSBC posits the benefits of its global network as if the facts spoke for themselves. Sometimes they do: "Premier" and "Advance", two global retail-banking products aimed at well-off people, have been big successes. But often they don't. The bank does not make better returns than its local peers, except in Hong Kong where it is dominant. It is a leading global credit-card operator but still managed to lose money in Mexican cards in recent years, just like supposedly less savvy rivals. Its transaction-services activities, which provide global financial plumbing for big companies, contribute just 12% of net operating income and have shrunk since 2008. And HSBC doesn't benefit much from geographically pooled funding. It gathers lots of excess deposits in Hong Kong, but local regulators, sensibly, limit the amount that can be farmed out to other bits of the group. The bank's initiatives to create global business lines in investment banking and consumer finance in the past decade were half-hearted and sometimes seemed like post-hoc attempts to justify the geographical spread that it had acquired.



Making a ton of money in Hong Kong, under any flag

Mr Gulliver is a strong believer in global reach. To make things work better he will have to improve the bank's economies of scale. One option is simply to lend more over the same fixed cost base. But loosening underwriting standards now to recapture market share lost three years ago is a risky approach. HSBC executives privately question the risk that Standard Chartered, which has outpaced it in Asia, is taking. The alternative to a lending splurge is to try again to push global product lines. The obvious one is investment banking, although the firm's chequered past and those British regulators may make that difficult. More promising may be a push into private banking, which needs less capital.

Chop chop

If HSBC cannot grow into something more coherent and profitable it will have to do what almost all tired conglomerates do at some point: take a hard look at its portfolio and cut off the rotten bits. The bank has been brutal in shrinking its American consumer-finance and subprime business, for which it always had distaste-its assets have almost halved since 2007. Yet HSBC has been remarkably tolerant of failure elsewhere. Mr Gulliver plans a round of cost-cutting, but he probably needs to go much further by simplifying the firm's federal structure, tackling the vested interests that seem to have allowed underperforming businesses to be tolerated, and killing off or selling those bits of the group that cannot be brought up to scratch.

To the contemporary HSBC staffer all that may sound barbaric. Yet by re-establishing a culture of accountability and discipline Mr Gulliver would not be betraying the bank's traditions but acting entirely in accordance with them. HSBC has lost its reputation as an astute buyer of banks. Its dream of being a leading firm in China is subject to the whim of that country's nationalistic government. The alternative vision, the only one that unites HSBC's disparate assets, is of a globally integrated bank. This is alluring but has proven hard in practice. Mr Gulliver is probably the last HSBC boss who will be given a chance to deliver it.

Financial careers

Go east, young moneyman

Ever more jobs in finance are migrating to growth markets, particularly in Asia



"A LOT of my friends are going to Asia and Latin America to do their internships," says Ben Zhang, a student at the University of Chicago's Booth School of Business who will do his in Hong Kong with Morgan Stanley. "It may be outside their comfort zone, but they see getting some experience there as helpful, since that's where many of the jobs will be."

The percentage of business-school graduates choosing finance as a career has dipped only slightly since the crisis, no doubt largely because pay in the industry has held up remarkably (some would say obscenely) well. But within the industry career priorities are changing, at least when it comes to location. Talent and transactions are migrating from London and New York to faster-growing markets, particularly in Asia. Though some headhunters predict indigestion in Hong Kong, Singapore and Shanghai this year after an overzealous bout of hiring, most are bullish on the region's long-term prospects.

Asia rising

Top three foreign destinations* of financial-service professionals based on job applications, 2010

Origin	Destination
Britain	US, Singapore, Hong Kong
Germany	Britain, Switzerland, US
Hong Kong	Singapore, Britain, China
Singapore	Hong Kong, Britain, US
United States	Britain, Hong Kong, Singapore

Source: eFinancialCareers *In descending order

This eastward march has grown more pronounced since the crisis. According to Sheffield Haworth, a recruiting firm, 31% of financial firms' external hires in Asia in 2010 transferred from Britain or America, compared with 8% the year before. The shift is also visible on eFinancialCareers, a leading recruitment website for the industry. Asian cities have climbed up the list of most popular destinations for applicants based in America and Britain (see table)-though that is partly the result of collapsing interest in the United Arab Emirates following the property bust in Dubai. Though not a top-three destination, Latin America is on the up, too. Fund managers in Brazil report a big increase in applications from American MBA graduates.

Many new recruits still want to spend their first few years in London or New York to "plug into [their firm's] global network", says Constance Melrose of eFinancialCareers. But several business-school career advisers and bank campus-

recruiters interviewed by *The Economist* say that a growing number seem willing to bypass this phase and go straight to markets they see as being the future. This is especially true of graduates with cultural links to those countries and of Westerners with relevant language skills, says Julie Morton, head of career services at Booth.

Banks are encouraging this trend. Under its Growth Markets Opportunity Programme, Goldman Sachs hires Asians and Latin Americans with MBAs from Western schools, puts them in New York or London for just one year, and whisks them off to more permanent positions in China, Brazil and so on. The firm is also trying to strengthen its links to local business schools: Goldman's global head of campus recruiting for banking, Sandra Hurse, spent most of the past month in Asia.

The allure of emerging markets is not just based on superior growth rates. Graduates see mature markets as saturated and emerging ones as offering greater job stability (Hong Kong and Singapore saw relatively few lay-offs in the crisis). Michael Malone, a career adviser at Columbia Business School, says some students think they will have a better chance of standing out and getting promoted in Shanghai or Mumbai than in New York. Another issue is visas: with Britain and America having grown less welcoming, foreigners are tempted to look elsewhere-though Singapore, too, has tightened restrictions a bit.

Then there is tax. Someone earning a base salary of $400,000 gets to keep 85% of it in Hong Kong or Singapore, versus 55% in London. Pre-tax pay packages are still higher on average in the West but the gap has narrowed. Factor in the tax advantage in Asia and you can end up earning significantly more there in many positions, says Tim Sheffield, the head of Sheffield Haworth. (This is no help to Americans, however, who pay similar amounts of tax wherever they live under America's tax-equalisation rules.)

Regulation matters, too. This week's Vickers commission report calmed fears that British universal banks would be forcibly broken up. But the political pressures on pay and other forms of bank-bashing in Britain and, to a lesser extent, America are driving some financiers overseas. Almost two-thirds of London-based bankers polled by Sheffield Haworth said they were willing to move to a more tax- and regulation-friendly environment. Asian countries, which have kept regulation fairly stable, are only too happy to exploit this competitive advantage. Their efforts may help to accelerate a nascent trend: international banks moving global divisional heads, and in HSBC's case its chief executive, eastward.

London and New York are hardly spent forces. Each remains the other's favourite destination for job applicants. Even in horrible years, they can be sure of seeing lots of business. The stigma attached to banking is fading: in 2010, 17% of finance students polled felt awkward telling friends they wanted to work in the City, compared with 35% the year before. When it comes to quality of life, London and New York still have huge appeal for the young, the single and the binge-drinking.

But for bankers with families, Asia has the big advantage of cheap domestic help. "For the same as a day's taxi fares in London you can employ a nanny or cook for a month," says one recruiter-though this is truer of Mumbai than Hong Kong. Singapore has good schools, infrastructure and weather, and lovely golf courses to boot. London-based investment bankers polled by Astbury Marsden, another recruitment firm, said they would rather work in Singapore than any other financial centre. London came second, Hong Kong third and New York a poor fourth.

For all the increased interest in working in Asia, demand for qualified labour exceeds supply. In February HSBC revealed that its top bankers in the region received 40% higher bonuses last year than their counterparts in London because, as its boss said, Asia "is where the pressure is" on pay. UBS's regional head has given warning that its profit margins there could be depressed for "a year or two" amid fierce competition for talent.

Demand is up not only from global banks but also from new entrants and regional players, such as Jeffries and Samsung Securities. Chinese banks are starting to poach. Some of these firms are dangling guaranteed cash bonuses in front of prospective hires, say headhunters in Asia. According to Ying Tao, a Chinese-born Harvard MBA student who has a job lined up at a hedge fund in London: "When I started looking for a job, a common reply was 'We don't have anything in London but how about Hong Kong?' They seemed desperate for qualified people out there."

Some wonder if the region's job market is ripe for a correction. One headhunter sees signs of a "herd mentality" encouraging "overbidding" and predicts that some firms' planned hiring expansions for the year won't be completed, especially since business was disappointing in the first quarter. Competition could recede as upstarts retreat. A few dare to

suggest that Asia could become a lot less attractive if China's economy sputters (see Economics focus). But it will take quite some bust in the east to shake the general belief that that's where the industry's future lies. The London bankers in the Astbury Marsden survey were asked which financial centre they expected to be the world's biggest in ten years' time. Nearly four-fifths picked one in Asia.

Index | Finance and Economics

Europe's banks

Follow the money

Is Germany bailing out euro-area countries to save its own banks?

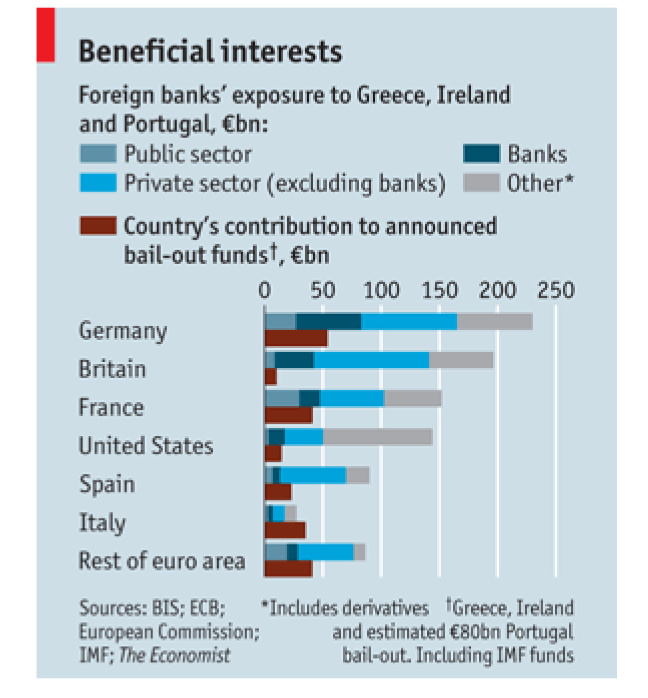
IF THE euro zone were an old-fashioned family, Germany would be the stern father telling his wayward children to go to bed early and not to spend all their pocket money at once. It has resisted efforts to ease the conditions attached to the bail-outs of Greece and Ireland, and is insisting that Portugal, which started negotiations on a bail-out this week, also gets licked into shape. (The European Central Bank, too, has a ring of the stern German in its insistence that banks in weaker euro-zone countries, Ireland's in particular, pay back their debts in full.) That seems fair: Germany is putting more money at risk in funding the errant trio than any other country. But some observers argue that the real bail-out is of Germany's own banks.

That depends, in part, on the assumptions you make about what might happen if one of the peripheral countries were to default. Start with government debt. Germany's two biggest banks, Deutsche Bank and Commerzbank, have a surprisingly low direct exposure to Greek, Irish and Portuguese governments. They held less than euro6 billion ($8.7 billion) in government debt from the three bail-out recipients at the end of last year, according to company disclosures. But the total exposure of the German banking system is a lot larger, at almost euro27 billion.

This suggests that the bulk of these sovereign-debt holdings are buried in small, not very savvy German banks. Germany's publicly owned Landesbanken would fit that bill nicely. They are already beset by low profitability, so cannot easily earn enough to offset losses, and their capital cushions are thin and partly composed of hybrid debt that under new rules will soon no longer count as capital. Many will have to raise equity to pass the next round of European stress tests. Among the first out of the gate is NordLB, which announced plans this week to convert hybrid capital into equity.

Sovereign defaults would also harm Hypo Real Estate, a bust German property and public-finance bank that is now owned by the state. In July last year it said it was owed almost euro8 billion by the Greek government and euro10 billion by Ireland.

Sovereign exposures nevertheless look manageable when set against total assets in the German banking system of some euro2.5 trillion. Most of the burden of a peripheral default would fall on banks in the defaulting countries themselves. A deep home bias has made many of them the largest holders of their own governments' debt. Calculations by the Bank of England on losses that would arise from haircuts to Greek, Irish, Portuguese and Spanish debt suggests that a 50% haircut would wipe out 70% of the equity in Greek banks, almost half of it in Portuguese and Spanish banks and about 10% of the equity in German and French banks.



That spells trouble of a different kind. Sovereign defaults would entail much more than just a haircut on German banks' government-bond exposures. It could easily lead to a slew of bank defaults-and corporate ones, too. German banks are owed twice as much by banks in the three bailed-out countries as they are by governments. Once corporate loans and other exposures are included, Germany's vulnerability is clear: its banks are owed some euro230 billion. These numbers would ratchet up further were Spain to default. German banks have an exposure to Spain that is about three-quarters as great as it is to Portugal, Greece and Ireland combined.

Not all of these debts would be affected by a sovereign default, let alone be wiped out. Derivatives exposures are already marked to market, for example. But compared with the potential costs of full-blown default, the amounts that Germany and other countries are likely to put into the three bail-out packages look like excellent value (see chart). The rescuers need not be quite so sanctimonious.

Index | Finance and Economics

Petri-dish economies: Colombia

Inflows, outperforming

The second article in our series on economies that exemplify global trends looks at Colombia's rising fortunes



"I WAS here ten years ago when the economy was in crisis and every day's news was worse than the day before. Now all the news is better than expected." Juan Carlos Echeverry was a top official in Colombia's finance ministry when the country, then violence-ridden, went through a messy mortgage bust and budget crunch in the late 1990s. Now, as finance minister, he is in charge of an economy on the rise.

Foreign investment is up, drawn by an improved security situation, the lure of minerals and a bouncy regional market. Public coffers are swelling, thanks to rising commodity prices and oil output. Standard & Poor's hiked Colombia's sovereign-debt rating to investment grade last month.

It is Mr Echeverry's task to manage the consequences of this good news. High oil prices could encourage outsize demands for government spending. A flood of foreign capital could send the peso soaring and cause credit bubbles, while threatening the viability of industries from cut flowers to food processing. The decision to create an integrated regional bourse with Peru and Chile will attract more money.

Colombia is not the only emerging economy to face these issues. Countries from Brazil to South Korea have introduced a plethora of taxes and restrictions to deter foreign inflows. But Colombia is one to watch. Along with Chile, it pioneered the use of capital-inflow controls in the 1990s. Yet its strategy today is subtly different from many others, with more weight on fiscal reforms and less on controls.

The country's technocrats do worry about the impact of inflows but they see the exchange rate as the most important shock absorber. And with Colombia's long-term prospects improving, they believe a gradually stronger currency is inevitable. Jose Dario Uribe, governor of the central bank, puts a lot of weight on using prudential rules to stop inflows causing financial instability. The central bank does not allow banks to borrow in foreign currency and then lend in pesos, for instance. It guards against maturity mismatches in foreign currency and it has long limited banks' foreign-exchange derivative bets.

Mr Uribe is less convinced that capital controls can do much to affect the exchange rate. Though no one rules them out, such controls are clearly not Colombia's first line of defence. And when the central bank does intervene to try to stem excessive strength in the peso, the tactics are different from, say, Brazil's.



On September 15th 2010 the central bank announced that it would buy $20m of foreign exchange every day for four months. That policy has been extended to mid-June. Mr Uribe is convinced that this kind of transparent, small, predictable intervention is much more effective than the large-scale but unpredictable accumulation of foreign-exchange reserves that other emerging markets have gone for. Colombia's currency has depreciated slightly over the past six months, in contrast to most others in the region (see chart). How much this owes to the intervention strategy is debatable. Roberto Steiner of Fedesarrollo, a think-tank, says the goal is to insulate the central bank from pressure to intervene more fiercely.

The big question is whether Colombia's government will be able to resist political pressures to spend. The budget deficit is likely to be well over 3% of GDP in 2011. Colombia urgently needs better infrastructure. Despite the government's military gains against the FARC guerrillas, plenty of money still needs to be spent on security and reparations. As Alejandro Gaviria at the Universidad de los Andes says: "Colombia faces the demands of conflict and post-conflict spending at the same time." And painfully high income inequality means pressure for social spending, too.

Mr Echeverry is trying hard to hold firm. A recent tax reform slashed tax breaks on investment. A Chilean-style fiscal rule, designed to limit the deficit and force the prudent use of commodity receipts, is working its way through Congress. But in a country whose constitutional court can force public spending (by, say, declaring that people have a right to expensive health care), that may not be enough. So the government is also pushing for a German-style constitutional amendment to enshrine the notion of fiscal sustainability. Mr Echeverry is confident. "The whole economic plan of our government is tailor-made to manage a boom," he boasts.

Index | Finance and Economics

China's foreign reserves

Who wants to be a triple trillionaire?

Window-shopping with China's central bank

Fantasy shopping

This year's projected oil output	$3.41 trn
US farms	$1.87 trn
PIGS'* sovereign debt	$1.51 trn
"Monetary" gold	$1.43 trn
Apple, Microsoft, IBM and Google	$916 bn
US military equipment	$414 bn
Manhattan real estate	$287 bn
Washington, DC real estate	$232 bn
50 most valuable sports teams	$50 bn

Sources: Various *Portugal, Ireland, Greece & Spain

BY THE end of last year, China's foreign-exchange reserves amounted to $2.85 trillion. Although China ran a rare trade deficit in the first quarter of this year on April 14th the country's central bank released new figures showing that its reserves at the end of March had soared above $3 trillion.

China's central bank has a lot of money but not a lot of imagination. It keeps a big chunk of its reserves in boring American government securities. That means it can count on getting its dollars back. But it frets about how much those dollars will be worth should America succumb to inflation or depreciation.

So what else could China do with the money? Instead of the dollar, China might fancy the euro. China could buy all of the outstanding sovereign debt of Spain, Ireland, Portugal and Greece, solving the euro area's debt crisis in a trice. And it would still have almost half of its reserves left over.

It might, alternatively, choose to abandon debt altogether and buy equity. China could gobble up Apple, Microsoft, IBM and Google for less than $1 trillion. It could also follow the lead of those sheikhs and oligarchs who like to buy English football clubs. According to *Forbes* magazine, the 50 most valuable sports franchises around the world were worth only $50.4 billion last year, less than 2% of China's reserves.

Another favoured sink for the world's riches is property. Perhaps China should buy some exclusive Manhattan addresses. Hell, why not buy all of Manhattan? The island's taxable real estate is worth only $287 billion, according to the New York City government. The properties of Washington, DC, are valued at a piffling $232 billion. China is accustomed to being Washington's banker. Why not become its landlord instead?

China could also allay its fears about energy, food and military security. Three trillion dollars would buy about 88% of this year's global oil supply. It would take only $1.87 trillion (at 2009 prices) to buy all of the farmland (and farm buildings) in the continental United States. And China could theoretically buy America's entire Department of Defence, which has assets worth only $1.9 trillion, according to its 2010 balance-sheet. Much of that figure is land, buildings and investments; the guns, tanks and other military gear are valued at only $413.7 billion.

These frivolous calculations illustrate the vast scale of China's reserves but also the great difficulty it faces in diversifying them. Any purchase big enough to warrant China's attention will also move the market against it. China can buy almost anything for a price-but almost nothing for today's price.

Index | Finance and Economics

The Galleon trial

The mosaic defence

Raj Rajaratnam defends his investment strategy in court



PEOPLE often say regrettable things but they usually don't have to hear their words played back to them. That's not true for Raj Rajaratnam, the former boss of Galleon Group, a hedge fund, who is on trial for insider trading. For the past five weeks Mr Rajaratnam has sat quietly in a New York courtroom while his phone conversations with friends and colleagues, which had been recorded by the government, were played for the jury.

In one taped conversation he appears to share unannounced revenue figures for Advanced Micro Devices (AMD), a semiconductor company, with Danielle Chiesi, a former hedge-fund executive who has since pleaded guilty to insider trading. "Tell me I'm the best on AMD now," he boasts. "You are the best," she replies.

The best Mr Rajaratnam can hope for at this juncture is the chance to clear his name by proving he did not make $63.8m from insider information, as the government contests. On April 11th his lawyers began their defence. Their main argument is that Mr Rajaratnam invested on the basis of diligent research, not illegal tips.

Richard Schutte, a former president at Galleon who helped wind down the firm, spent several days on the witness stand this week testifying about Galleon's culture of number-crunching and accountability. Employees were expected to arrive at work at 7am, and discussed ideas at a daily meeting before the markets opened. They were fined $25 if they arrived at the meeting late. Portfolio managers and analysts wrote weekly reports that outlined their rationale for buying or selling equities, and shared them with Mr Rajaratnam.

His lawyers insist that much of Galleon's trading was based on publicly available information. Traders patched together data from equity analysts' reports, company announcements and newspaper articles, a practice known as the "mosaic theory" of investing. Galleon traders also met with company executives. The defence pointed out that Mr Rajaratnam had met Gary Cohn, Goldman Sachs's president, in 2008 to talk about the bank's outlook before selling Goldman stock. Nothing wrong with that, but the prosecution says he was also getting information from a different source. Jurors have listened to a recording of Mr Rajaratnam telling a trader he'd "heard yesterday from somebody who is on the board of Goldman Sachs that they are going to lose $2 per share."

What has been a plodding and uneventful presentation by the defence so far could heat up if Mr Rajaratnam testifies. But most suspected he would not be called to the stand. Instead the defence was due to call Gregg Jarrell, a University of Rochester professor and former Securities and Exchange Commission economist, who is expected to argue that Mr Rajaratnam's trading patterns do not suggest insider trading. Geoffrey Canada, who runs a non-profit organisation called the Harlem Children's Zone, has already testified about Mr Rajaratnam's generosity and "genuine concern for children".

Writing big cheques to charity does not prove a person's integrity, however. The defence's main hope is to make jurors question whether Mr Rajaratnam's trading strategy was illegal. This is a criminal trial: prosecutors have to convince the jury that Mr Rajaratnam is guilty "beyond a reasonable doubt". By introducing so many trading records and reports that show Galleon did legitimate analysis, the defence aims to suggest that Mr Rajaratnam was nothing more than a meticulous researcher. Most observers think acquittal is a long shot. If Mr Rajaratnam does beat the charges, his lawyers will have earned their fees.

Currencies

Carry on

Rich countries' central banks are on divergent paths. So are their currencies



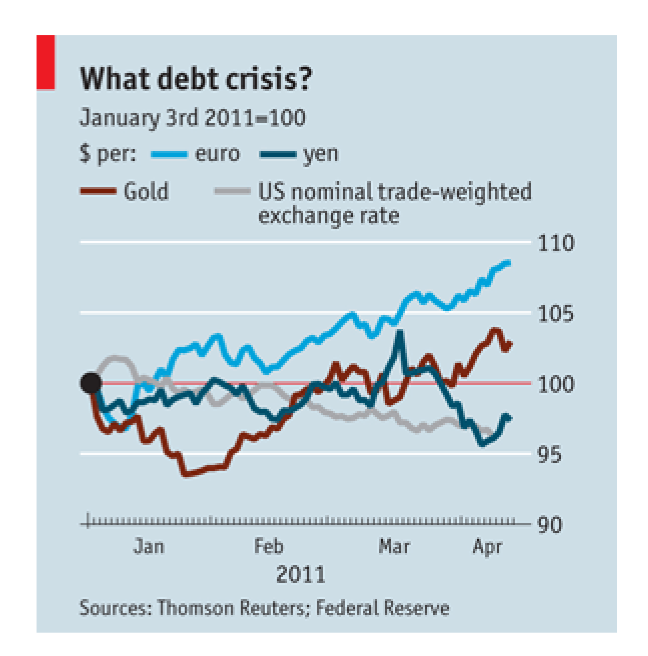
Gold can fall as well as rise

THE Japanese yen has seen dramatic gyrations in its value since the earthquake and tsunami of March 11th. Immediate bets by speculators-or "sneaky thieves", in the words of one Japanese official-that companies would have to repatriate funds to cover insurance payouts and reconstruction costs led its value to spike following the disaster. Concerned about the impact of a pricey currency on Japan's post-disaster recovery, the central banks of the G7 countries flooded the market with more than $25 billion of the Japanese currency, sending the yen tumbling by nearly 3% in a single day. It kept on falling, breaching Â¥85 to the dollar on April 6th.

The yen is now being buffeted by opposing forces. When risk perceptions among investors rise-for instance, after the announcement on April 12th that the continuing nuclear crisis in Japan was being upgraded to the same level of seriousness as the Chernobyl disaster-upward pressure is applied to the yen. Analysts reckon that currencies like the yen

and the Swiss franc, which are traditionally seen as havens in times of trouble, appreciate whenever investors believe that the environment is riskier. Gold, which hit a record nominal high on April 11th, is another beneficiary of this "flight to safety".

The yellow metal also benefits from fears that loose monetary policy and rising oil prices will unleash inflation. Such concerns, and the response to them by the world's central banks, lie behind a second, downward source of pressure on the yen-the "carry trade", in which investors borrow in low-yielding currencies to finance investments in higher-yielding ones.



Many argue that the European Central Bank's decision on April 7th to raise the policy rate in the euro area, and the prospect of further rises to come, has reinvigorated the carry trade. An interest-rate gap is opening between currencies like the dollar and the yen on the one hand, where monetary policy is likely to remain ultra-loose, and higher-yielding ones like the euro on the other. This gap may explain the strength of the euro, which has risen against the dollar in recent weeks despite endless euro-zone sovereign-debt worries (see chart).

It also explains the sustained appreciation of the Australian dollar, which has strengthened markedly since the start of the year. The Reserve Bank of Australia (RBA) was among the first rich-world central banks to start raising interest rates after virtually all countries had slashed them during the crisis. Australia's deep economic linkages to booming China via its commodity exports mean that the RBA is unlikely to reverse its policy stance in the near future.

The Federal Reserve, too, is unlikely to change direction soon, which implies continued dollar weakness. The Fed's daily index of the dollar's value against major traded currencies fell to 69.92 on April 8th, the lowest level since May 23rd 2008. Its monthly index of the dollar's value against major currencies fell in March for the fourth month in a row.

For Americans concerned about their country's export prospects, the depressed value of the greenback ought to be good news. In February, the most recent month for which trade data are available, the dollar was 4.5% cheaper in real terms than a year earlier. But although America's trade deficit did fall in February, it was only because exports fell less steeply than imports. That month's deficit was still $6 billion higher than a year earlier, when Barack Obama announced a plan to double exports in five years. Achieving that will take more than a cheap currency.

Assicurazioni Generali

Cesare: Et tu?

Boardroom ructions at Italy's largest insurer

NO NEED for a knife. The threat of forcible ejection and the offer of a huge euro16.6m ($24m) exit package was enough to convince Cesare Geronzi to resign on April 6th as the chairman of Assicurazioni Generali, Italy's largest insurer. He was replaced two days later by the more emollient figure of Gabriele Galateri, Generali's deputy chairman from 2003 until last year.

Mr Geronzi, a longtime mover in Italian corporate and political circles, antagonised much of the board in his one-year reign, thanks largely to outspoken ideas on the firm's future strategy. But his spell as chairman did not seem to throw the company off balance. Generali recorded a leap of 30% in net profits to euro1.7 billion in 2010. Giovanni Perissinotto, Generali's chief executive, puts its strong performance in the life sector in particular down to active investment and proprietary distribution networks in Italy, France and Germany.



According to a person close to recent events, decent results owed much to decisions taken well before Mr Geronzi's arrival and a continuation of his chairmanship would have placed a cloud over the future. A perception that Generali is trapped within a web of political and industrial connections may explain why its share price has lagged behind its competitors' (see chart).

The stock may not soar even now. Generali plans to make savings in IT, on which it currently spends around euro1.5 billion annually, and to tighten up claims management. In its core but mature markets in western Europe, the company will focus on retirement and health-care products. Elsewhere, eastern Europe is seen as having lots of potential, as is private banking in Asia.

But the economic headwinds are gusty, particularly for non-life activity. Companies are keen to lower their insurance premiums. The problems posed by motor insurance in Italy, where Generali generates one-third of all its non-life business, have worsened along with the economy: fraud and dubious claims have risen as families try to balance budgets. There is not much Generali can do to prevent events like the floods in France and central Europe that affected last year's results, although it is planning to build an in-house reinsurance unit.

Nor does Mr Geronzi's departure dispel doubts about the company's freedom of movement. Mediobanca, a heavily connected investment bank, remains Generali's biggest shareholder. The insurer's equity portfolio contains stakes in several Italian firms considered to be of strategic national interest. By selling those in RCS Mediagroup, Atlantia, Pirelli and Intesa Sanpaolo, as well as its indirect shareholding in Telecom Italia, Generali could show its independence. But the gentlemanly Mr Galateri, himself a former chairman of Mediobanca, may not have the steel for that.

Economics focus

BRIC wall

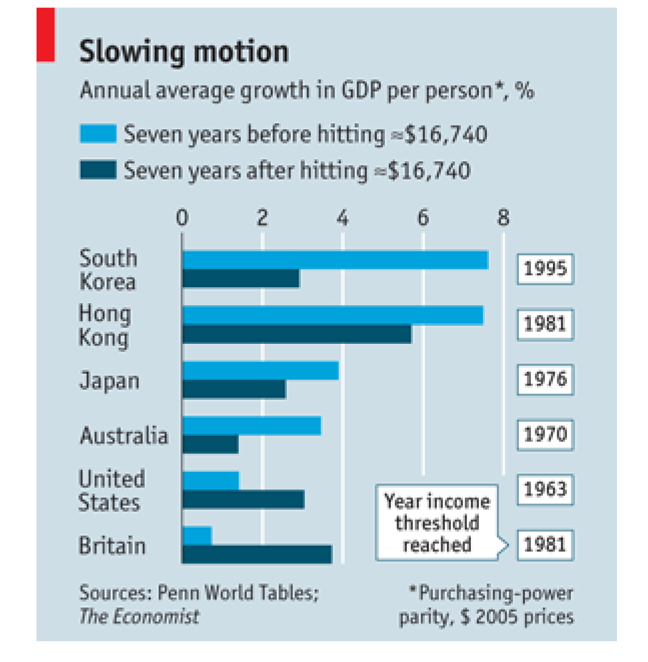
Growth tends to slow when GDP per head reaches a certain threshold. China is getting close

THE economic crisis may have been debilitating for the rich world but for emerging markets it has been closer to a triumph. In 2010 China overtook a limping Japan as the world's second-largest economy. It looks sets to catch America within a decade or two. India and Brazil are growing rapidly. The past few years have reinforced the suspicion of many that the story of the century will be the inexorable rise of emerging economies. If projections of future growth look rosy for emerging markets, however, history counsels caution. The post-war period is rich in examples of blistering catch-up growth. But at some point growth starts to disappoint. Gaining ground on the leaders is far easier than overtaking them.

Rapid growth is initially easy because the leader has already trodden a clear path. Developing countries can borrow existing technologies from countries that have already become rich. Advanced economies may be stuck with obsolete infrastructure; laggards can skip right to the shiniest and best. Labour productivity soars as poor economies shift workers from agriculture to a growing manufacturing sector. And rapid income growth among young workers boosts savings and fuels investment.

But the more an emerging economy resembles the leaders, the harder it is to sustain the pace. As the stock of borrowable ideas runs low, the developing economy must begin innovating for itself. The supply of cheap agricultural labour dries up and a rising number of workers take jobs in the service sector, where productivity improvements are more difficult to achieve. The moment of convergence with the leaders, which once seemed within easy reach, retreats into the future. Growth rates may slow, as they did in the case of western Europe and the Asian tigers, or they may falter, as in Latin America in the 1990s.

The world's reliance on emerging markets as engines of growth lends urgency to the question of just when this "middle-income trap" is sprung. In a new paper* Barry Eichengreen of the University of California, Berkeley, Donghyun Park of the Asian Development Bank and Kwanho Shin of Korea University examine the economic record since 1957 in an attempt to identify potential warning-signs. The authors focus on countries whose GDP per head on a purchasing-power-parity (PPP) basis grew by more than 3.5% a year for seven years, and then suffered a sharp slowdown in which growth dipped by two percentage points or more. They ignore slowdowns that occur when GDP per head is still below $10,000 on a PPP basis, limiting the sample to countries enjoying sustained catch-up growth. What emerges is an estimate of a critical threshold: on average, growth slowdowns occur when per-head GDP reaches around $16,740 at PPP. The average growth rate then drops from 5.6% a year to 2.1%.



This estimate passes the smell test of history (see chart). In the 1970s growth rates in western Europe and Japan cooled off at approximately the $16,740 threshold. Singapore's early-1980s slowdown matches the model, as does the experience of South Korea and Taiwan in the late 1990s. As these examples indicate, a deceleration need not precipitate disaster. Growth often continues and may accelerate again; the authors identify a number of cases in which a slowdown proceeds in steps. Japan's initial boom lost steam in the early 1970s, but its economy continued to grow faster than other rich nations until its 1990s blow-up.

In the right circumstances the good times may be prolonged, allowing an economy to reach a higher income level before the inevitable slowdown. When America passed the threshold it was the world leader and was able to keep growing rapidly so long as its own innovative prowess allowed. Britain's experience indicates economic liberalisation or a fortunate turn of the business cycle may also prevent the threshold from binding at once.

Openness to trade appears to be a potent stimulant: the authors attribute the outperformance of Hong Kong and Singapore to this effect. Lifting consumption to just over 60% of GDP is useful, as is a low and stable rate of inflation. Neither financial openness nor changes of political regime seem to matter much, but a large ratio of workers to dependents reduces the odds of a slowdown. An undervalued exchange rate, on the other hand, appears to contribute to a higher probability of a slowdown. The reason for this is not clear but the authors suggest that undervaluation could lead countries to neglect their innovative capacity, or may contribute to imbalances that choke off a boom.

Middle Kingdom, middle income

The authors are careful to say that there is no iron law of slowdowns. Even so, their analysis is unlikely to cheer the leadership in Beijing. China's torrid growth puts it on course to hit the $16,740 GDP-per-head threshold by 2015, well ahead of the likes of Brazil and India. Given the Chinese economy's long list of risk factors-including an older population, low levels of consumption and a substantially undervalued currency-the authors suggest that the odds of a slowdown are over 70%.

It is hazardous to extend any analysis to a country as unique as China. The authors acknowledge that rapid development could shift inland, where millions of workers have yet to move into manufacturing, while the coastal cities nurture an ability to innovate. The IMF forecasts real GDP growth rates above 9% through to 2016; a slowdown to 7-8% does not sound that scary. But past experience indicates that slowdowns are frequently accompanied by crises. In East Asia in the late 1990s it became clear that investments which made sense at growth rates of 7%, say, did not at expansion rates of 5%. Political systems may prove similarly vulnerable: it has been many years since China has to deal with an annual growth rate below 7%. Structural reforms can help to cushion the effects of a slowdown. It would be wise for China to pursue such reforms during fat years rather than the leaner ones that will, eventually, come.

* "When Fast Growing Economies Slow Down: International Evidence and Implications for China". NBER working paper, March 2011

The evolution of language

Babel or babble?

Languages all have their roots in the same part of the world. But they are not as similar to each other as was once thought



WHERE do languages come from? That is a question as old as human beings' ability to pose it. But it has two sorts of answer. The first is evolutionary: when and where human banter was first heard. The second is ontological: how an individual human acquires the power of speech and understanding. This week, by a neat coincidence, has seen the publication of papers addressing both of these conundrums.

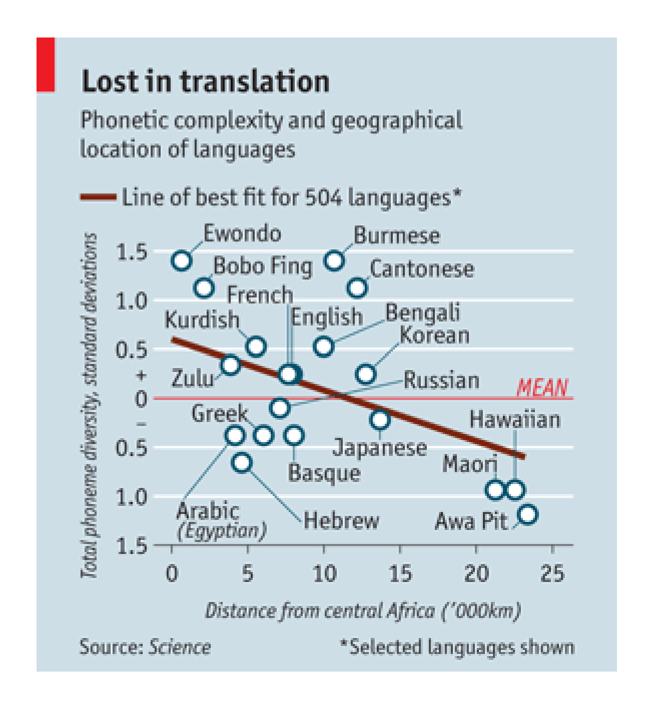
Quentin Atkinson, of the University of Auckland, in New Zealand, has been looking at the evolutionary issue, trying to locate the birthplace of the first language. Michael Dunn, of the Max Planck Institute for Psycholinguistics in the Netherlands, has been examining ontology. Fittingly, they have published their results in the two greatest rivals of scientific journalism. Dr Atkinson's paper appears in *Science*, Dr Dunn's in *Nature*.

Travellers' tales

The obvious place to look for the evolutionary origin of language is the cradle of humanity, Africa. And, to cut a long story short, it is to Africa that Dr Atkinson does trace things. In doing so, he knocks on the head any lingering suggestion that language originated more than once.

One of the lines of evidence which show humanity's African origins is that the farther you get from that continent, the less diverse, genetically speaking, people are. Being descended from small groups of relatively recent migrants, they are more inbred than their African forebears.

Dr Atkinson wondered whether the same might be true of languages. To find out, he looked not at genes but at phonemes. These are the smallest sounds which differentiate meaning (like the "th" in thin; replace it with "f" or "s" and the result is a different word). It has been known for a while that the less widely spoken a language is, the fewer the phonemes it has. So, as groups of people ventured ever farther from their African homeland, their phonemic repertoires should have dwindled, just as their genetic ones did.



To check whether this is the case, Dr Atkinson took 504 languages and plotted the number of phonemes in each (corrected for recent population growth, when significant) against the distance between the place where the language is spoken and 2,500 putative points of origin, scattered across the world. The relationship that emerges suggests the actual point of origin is in central or southern Africa (see chart), and that all modern languages do, indeed, have a common root.

That fits nicely with the idea that being able to speak and be spoken to is a specific adaptation-a virtual organ, if you like-that is humanity's killer app in the struggle for biological dominance. Once it arose, *Homo sapiens* really could go forth and multiply and fill the Earth.

The details of this virtual organ are the subject of Dr Dunn's paper. Confusingly, though, for this neat story of human imperialism, his result challenges the leading hypothesis about the nature of the language organ itself.

Grammar or just rhetoric?

The originator of that hypothesis is Noam Chomsky, a linguist at the Massachusetts Institute of Technology. Dr Chomsky argues that the human brain comes equipped with a hard-wired universal grammar-a language instinct, in the elegant phrase of his one-time colleague Steven Pinker. This would explain why children learn to speak almost effortlessly.

The problem with the idea of a language instinct is that languages differ not just in their vocabularies, which are learned, but in their grammatical rules, which are the sort of thing that might be expected to be instinctive. Dr Chomsky's response is that this diversity, like the diversity of vocabulary, is superficial. In his opinion grammar is a collection of modules, each containing assorted features. Switching on a module activates all these features at a stroke. You cannot pick and choose within a module.

For instance, languages in which verbs precede objects will always have relative clauses after nouns; a language cannot have one but not the other. A lot of similar examples were collected by Joseph Greenberg, a linguist based at Stanford, who died in 2001. And, though Greenberg himself attributed his findings to general constraints on human thought rather than to language-specific switches in the brain, his findings also agree with the Chomskyan view of the world. Truly testing that view, though, is hard. The human brain cannot easily handle the connections that need to be made to do so. Dr Dunn therefore offered the task to a computer. And what he found surprised him.

Place your bets

To find out which linguistic features travel together, and might thus be parts of Chomskyan modules, means drawing up a reliable linguistic family tree. That is tricky. Unlike biologists, linguists do not have fossils to guide them through the past (apart from a few thousand years of records from the few tongues spoken by literate societies). Also, languages can crossbreed in a way that species do not. English, for example, is famously a muddle of German, Norse and medieval French. As a result, linguists often disagree about which tongues belong to a particular family.

To leap this hurdle, Dr Dunn began by collecting basic vocabulary terms-words for body parts, kinship, simple verbs and the like-for four large language families that all linguists agree are real. These are Indo-European, Bantu, Austronesian (from South-East Asia and the Pacific) and Uto-Aztecan (the native vernaculars of the Americas). These four groups account for more than a third of the 7,000 or so tongues spoken around the world today.

For each family, Dr Dunn and his team identified sets of cognates. These are etymologically related words that pop up in different languages. One set, for example, contains words like "night", "Nacht" and "nuit". Another includes "milk" and "Milch", but not "lait". The result is a multidimensional Venn diagram that records the overlaps between languages.

Which is fine for the present, but not much use for the past. To substitute for fossils, and thus reconstruct the ancient branches of the tree as well as the modern-day leaves, Dr Dunn used mathematically informed guesswork. The maths in question is called the Markov chain Monte Carlo (MCMC) method. As its name suggests, this spins the software equivalent of a roulette wheel to generate a random tree, then examines how snugly the branches of that tree fit the modern foliage. It then spins the wheel again, to tweak the first tree ever so slightly, at random. If the new tree is a better fit for the leaves, it is taken as the starting point for the next spin. If not, the process takes a step back to the previous best fit. The wheel whirrs millions of times until such random tweaking has no discernible effect on the outcome.

When Dr Dunn fed the languages he had chosen into the MCMC casino, the result was several hundred equally probable family trees. Next, he threw eight grammatical features, all related to word order, into the mix, and ran the game again.

The results were unexpected. Not one correlation persisted across all language families, and only two were found in more than one family. It looks, then, as if the correlations between grammatical features noticed by previous researchers are actually fossilised coincidences passed down the generations as part of linguistic culture. Nurture, in other words, rather than nature. If Dr Dunn is correct, that leaves Dr Chomsky's ideas in tatters, and raises questions about the very existence of a language organ. You may be sure, though, that the Chomskyan heavy artillery will be making its first ranging shots in reply, even as you read this article. Watch this space for further developments.

Index | Science & Technology

Palaeontology

Remember the tooth

A link is made in an ancient ecosystem



A puncture wound

WHO ate whom in the food chains of the past is rarely clear. Though it is obvious which species were predators and which prey, the subtle specialisations of feeding habit that allow many types of carnivore to co-exist are rarely preserved in the fossil record.

Rarely, but not never. That is why the recent discovery of a Jurassic ammonite with a shark's tooth embedded in its shell has excited palaeontologists. The ammonite in question, *Orthaspidoceras*, a species that thrived 155m years ago, was part of the collection of an amateur who did not realise the significance of what he had found. Romain Vullo of the University of Rennes, however, did-and he has brought the discovery to the attention of the scientific world in the pages of *Naturwissenschaften*.

Ammonites were both predators and prey. They occupied a position in the Mesozoic oceans similar to that of modern squid. Like squid, they were swimming tentacled molluscs-a group called the cephalopods. Unlike squid, though, they had protective shells. These shells were divided internally into gas-filled chambers. The result had neutral buoyancy, allowing the animal to move (like squid) by jet propulsion. Modern pearly nautiluses, whose relationship to ammonites is much debated, have a similar arrangement.

What ammonites-or, at least, some of them-ate became clear earlier this year when an X-ray showed a small crustacean in the jaws of a species called *Baculites*. But what ate ammonites has never been shown in such an unambiguous manner. Some ammonite fossils have tooth marks that look as though they were made by huge reptilian predators called mosasaurs. Some appear to have been attacked by the beaks of other cephalopods. And some seem to have been bitten by sharks. On top of that, coprolites, as palaeontologists politely describe fossil faeces, have turned up with ammonite shells in them. Based on comparisons with modern evacua, these are probably from sharks.

But which sharks? Dr Vullo's ammonite nails one culprit. The tooth belongs to a species called *Planohybodus*. And that is a surprise. Those modern sharks that eat shelled animals have robust teeth for crunching through hard exteriors. The teeth of *Planohybodus*, in contrast, were slender and pointed-the sort usually associated with grasping and tearing at flesh. In a modern predator, that would indicate the habit of eating fish.

That a shark with teeth like this would try to make a meal of an ammonite is, at first sight, odd. But second thoughts provide a possible explanation. Ammonites' manoeuvrability would have depended crucially on their buoyancy control. Even a small puncture to the shell, which a pointed tooth would be well able to deliver, would let the water in and cause

that control to vanish. Since ammonites could not withdraw entirely into their shells for self-defence, it would then just be a question of dragging the creature out of its chamber in order to eat it. And for that, sharp, pointed teeth are ideal.

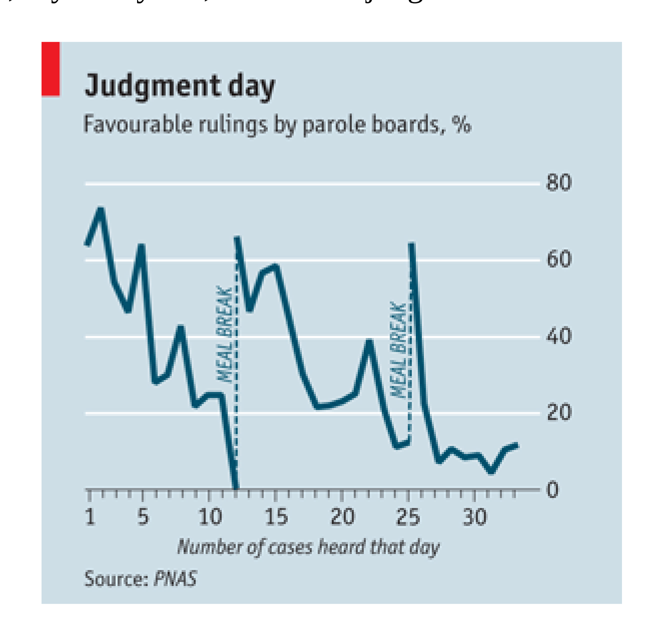
Index | Science & Technology

The science of justice

I think it's time we broke for lunch...

Court rulings depend partly on when the judge last had a snack

AROUND the world, courthouses are adorned with a statue of a blindfolded woman holding a set of scales and a sword: Justice personified. Her sword stands for the power of the court, her scales for the competing claims of the petitioners. The blindfold (a 15th-century innovation) represents the principle that justice should be blind. The law should be applied without fear or favour, with only cold reason and the facts of the case determining what happens to the accused. Lawyers, though, have long suspected that such lofty ideals are not always achieved in practice, even in well run judicial systems free from political meddling. Justice, say the cynics, is what the judge had for breakfast. Now they have proof.



A paper in the *Proceedings of the National Academy of Sciences* describes how Shai Danziger of Ben-Gurion University of the Negev and his colleagues followed eight Israeli judges for ten months as they ruled on over 1,000 applications made by prisoners to parole boards. The plaintiffs were asking either to be allowed out on parole or to have the conditions of their incarceration changed. The team found that, at the start of the day, the judges granted around two-thirds of the applications before them. As the hours passed, that number fell sharply (see chart), eventually reaching zero. But clemency returned after each of two daily breaks, during which the judges retired for food. The approval rate shot back up to near its original value, before falling again as the day wore on.

To be sure, mealtimes were not the only thing that predicted the outcome of the rulings. Offenders who appeared prone to recidivism (in this case those with previous convictions) were more likely to be turned down, as were those who were not in a rehabilitation programme. Happily, neither the sex nor the ethnicity of the prisoners seemed to matter to the judges. Nor did the length of time the offenders had already spent in prison, nor even the severity of their crimes (as assessed by a separate panel of legal experts). But after controlling for recidivism and rehabilitation programmes, the meal-related pattern remained.

The researchers offer two hypotheses for this rise in grumpiness. One is that blood-sugar level is the crucial variable. This, though, predicts that the precise amount of time since the judge last ate will be what matters. In fact, it is the number of cases he has heard since his last break, not the number of hours he has been sitting, which best matches the data. That is consistent with a second theory, familiar from other studies, that decision making is mentally taxing and that, if forced to keep deciding things, people get tired and start looking for easy answers. In this case, the easy answer is to maintain the status quo by denying the prisoner's request.

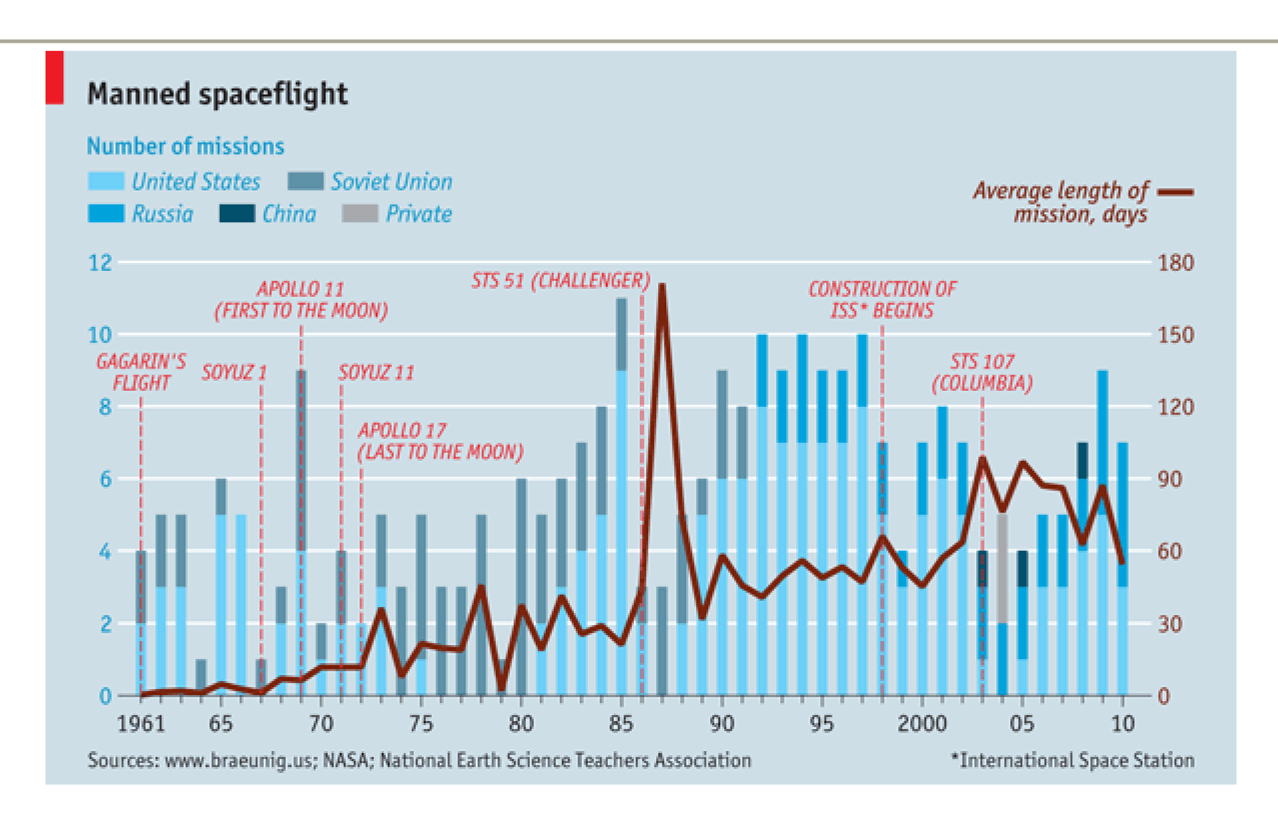
Two further findings buttress the idea that it is the psychological load of decision making which matters. First, the average unfavourable decision (unfavourable to the prisoner, that is) took less time to arrive at (5.2 minutes) than the average favourable one (7.4 minutes). Second, it also took more time to explain. Written verdicts in favourable rulings averaged 90 words, compared with just 47 for unfavourable ones.

In truth, these results, though disturbing, are unsurprising. Judges may be trained to confine themselves to the legally relevant facts before them. But they are also human, and thus subject to all sorts of cognitive biases which can muddy their judgment. Other fields are familiar with human imperfectibility, and take steps to ameliorate it. Pilots, for instance, are given checklists to follow, partly in order to combat the effects of fatigue. Lorry drivers in the European Union are not allowed to drive for more than four and a half hours without taking a break. Dr Danziger's co-author, Jonathan Levav of Columbia University in New York, wonders whether the law should consider similar arrangements. Some, of course, already do. English judges, legendary for their prandial proclivities, are way ahead of him.

Index | Science & Technology

Human spaceflight

Reaching for the stars



Fifty years have elapsed since a Soviet cosmonaut, Yuri Gagarin, lit the blue touchpaper on the era of manned spaceflight. Progress was rapid-only eight years separated Gagarin's flight from the infinitely more complicated mission that put Neil Armstrong and Buzz Aldrin on the surface of the moon. Although the moon landings handed a temporary victory to America, the Soviet Union dominated manned spaceflight for the next decade, including some pioneering missions to the *Salyut* space stations to test the effects of long periods aloft and several extended missions to *Salyut*'s successor *Mir*, in the

late 1980s. Only with the rise of the Space Shuttle programme, beginning in 1981, and the dissolution of the Soviet Union a decade later, did America retake the crown.

Manned spaceflight is no longer a two-horse race. China entered it in 2003. A year later three privately financed suborbital missions were made in Mojave Aerospace's craft, *SpaceShipOne*. Rocketeering, though, has always been dangerous. Four missions have killed 18 astronauts between them. Two were Soviet (*Soyuz 1* and *Soyuz 11*) and two American (the shuttles *Challenger* and *Columbia*). Other astronauts have died in accidents on Earth. After the losses of *Challenger* and *Columbia*, America's shuttle fleet was grounded, which explains the big drop in missions following both accidents.

Index | Books & Arts

Goldman Sachs

Long on chutzpah, short on friends

The firm that came to dominate world finance

Money and Power: How Goldman Sachs Came to Rule the World. By William Cohan. *Doubleday; 672 pages; $30.50. Allen Lane; pound25.* Buy from Amazon.com, Amazon.co.uk



ONCE upon a time, the evening before a long Memorial Day weekend, a senior partner of Goldman Sachs kept 40 new recruits waiting in a conference room for five hours, until 10pm, just to teach them the value of patience. The three who left early, overcome by the urge to begin their holidays, were sacked days later.

Pointless cruelty? Or a simple way to communicate the corporate culture? The paradoxical message of William Cohan's compelling history of the world's most envied and-recently at least-most pilloried securities firm is that much of what Goldman does seems to warrant admiration and opprobrium in equal measure. There is no starker example than the role it played in the global credit crisis when it dodged the bullets that floored many rivals, but did so by cashing in on others' misery and pushing the bounds of ethics.

Goldman started out in 1869 as a dealer in commercial paper. As it entered new businesses its culture remained remarkably cohesive, thanks to strong leadership and its eschewal of big acquisitions. It has long been considered the best risk manager on Wall Street. This helps it attract the brightest recruits, some of whom have to endure more than 30 interviews before being offered a job. Goldmanites are expected to work from dawn till night and to value teamwork over individual glory.

But some of the beliefs on which the firm was founded have been eroded, especially since it went public in 1999. Goldman claims to put its clients first; indeed, that is the first of its 14 "business principles". Yet it was selling them toxic mortgage securities long after it put on the "big short"-a highly lucrative bet against housing in 2006-07 that, as internal e-mails attest, was blessed by Goldman's top brass.

This trade, a "Houdini act" that netted Goldman $4 billion in profit, has featured in other books about the crisis, such as Gregory Zuckerman's "The Greatest Trade Ever" (2009) and Michael Lewis's "The Big Short" (2010). But Mr Cohan provides plenty of fresh material, for instance on the "Kabuki theatre" that was the relationship between John Paulson, a hedge-fund manager who made billions shorting mortgages, and Josh Birnbaum, the Goldman trader behind the "big short". Mr Birnbaum initially tried to frighten Mr Paulson-a Goldman client-into backing off from his audacious trade, but when the fund manager held firm Mr Birnbaum was persuaded of its merits and began to copy him instead.

The book offers the best analysis yet of Goldman's increasingly tangled web of conflicts. As its trading businesses have mushroomed-to well beyond the size of its investment bank-clients have become increasingly confused about whether the firm is an agent or a competitor. It is often both. Goldman has pushed this envelope further than other investment banks, believing it had the skill to manage the resulting conflicts. It insists that the Chinese walls separating its traders and bankers are always impermeable.

But outsiders are less inclined to trust it these days. Using client information to increase its trading edge-if that is what Goldman does-may not be against the law, but it is hardly honourable. As the author puts it, the scandal may not be what's illegal but what's legal.

Controversy also swirls around Goldman's "marks", or the prices at which it valued its mortgage holdings during the crisis. These were much lower than those of its rivals, drawing accusations that it was trying to force them to mark their portfolios down to the same level so that it could pick up assets on the cheap in the ensuing wave of firesales.

Goldman's aggressive stance certainly caused massive pain, speeding the demise of Bear Stearns and AIG. But as mortgage delinquencies ballooned, Goldman's marks were shown to be more accurate than those of the other big houses. Its longstanding "mark-to-market" discipline meant it was better placed to face the truth. There is no evidence of a conspiracy to post unreasonably low valuations. There was, in fact, a vigorous debate within Goldman about the right level, just as there was over the firm's overall risk levels. Angry at being reined in by its powerful risk managers, traders dubbed them the "VAR police", a reference to the value-at-risk models they used to measure how much was on the line.

Goldmanites feel their firm has been unfairly singled out as a symbol of greed. Some blame that on botched public relations. Goldman has, for instance, shown remarkably little humility for a firm that, for all its risk-management heroics, was almost swept away as the crisis deepened in 2008. (Conversely, it has had to pretend to be dumber than it really was in order to deflect criticism of the "big short".)

How much lasting damage has all this done to the firm? In its favour, Goldman has a remarkable record of bouncing back from adversity, whether the 1929 crash, near-fatal interest-rate bets in the 1990s or the infighting over its IPO. Friends and foes alike marvel at its skill at analysing market trends and responding quickly.

But it is vulnerable. Most clients have stuck with it so far, perhaps fearful that alienating the firm would be bad for business: Goldman is still seen as having unparalleled deal flow. But they are questioning its methods as never before, as are politicians; the latest slaps are in a Senate report released this week. The political connections that earned Goldman the sobriquet Government Sachs have been loosened by the crisis. (Jon Corzine, pictured right above, who was appointed Goldman's CEO in 1994, was for a while governor of New Jersey and his successor, Henry Paulson, left, went on to become President George Bush's treasury secretary.) A press that once put Goldman on a pedestal prefers today to put the

boot in. The biggest danger, however, lies within. The firm's DNA may have mutated to the point where it works against all of those worthy principles, particularly client-centricity.

"Money and Power" is a return to form for Mr Cohan, whose last book, about the final days of Bear Stearns, lacked the epic sweep of his prize-winning history of Lazard Freres, "The Last Tycoons" (2007). The writing is crisp and the research meticulous, drawing on reams of documents made publicly available by congressional committees and the Financial Crisis Inquiry Commission. The book has flaws: there is too much on well-trodden events from the distant past, too little on the traumatic weeks after AIG's bail-out, when Goldman came close to death. And, for all the evidence presented, it fails to provide a definitive answer to the question of whether the firm's success owes more to its brilliance or to its ability to find all sorts of ways to load the dice. But that might just be because the answer is a bit of both.

Index | Books & Arts

Climate change

Club (not too) tropicana

Some good ideas about how to break the gridlock

Global Warming Gridlock: Creating More Effective Strategies for Protecting the Planet. By David Victor. *Cambridge University Press; 392 pages; $40 and pound25.* Buy from Amazon.com, Amazon.co.uk



Lying, waiting, hoping

THE natural processes which dispose of carbon dioxide are, in aggregate, rather slow, which means that an increase in the atmosphere's carbon-dioxide level will, left to itself, last a long time. David Victor, a professor at the University of

California, San Diego, has a keen eye for such simple basics and the uncomfortable ways they may fit together. He sees this one as underlying all three of the things that make climate change a particularly pernicious sort of problem.

In the face of such slow removal, the level of the gas can't be lowered simply by stabilising the rate of emission; instead emissions must be cut nearly to zero. Because the harm the gas does is slow and cumulative, the benefits for any such cuts in emission will be delayed and uncertain, whereas the costs are all up front. And gas's longevity means it is spread more or less evenly around the world, with the result that the fate of a country's climate depends not on its own emissions, but on those of the world as a whole. A challenge that requires fundamental shifts in the energy economy for the sake of benefits that will be both a long time coming and subject to a pernicious free-rider problem was never going to be an easy one to solve. Little surprise that the world isn't up to it.

Mr Victor is broadly versed in climate change, good on the science, the energy- related business and the politics as well as the policy, and a more engaging writer than most academics who study international relations. This is just as well, as his new book is in most other ways a depressing read, as well as an insightful one. It shows that the world's current approach to the problem of climate change is a mostly ineffective mess, and that although there are alternative approaches-this is not a fatalistic book-they will be hard and time-consuming to get up and running. This means that the two-degree limit which current negotiations want to (but won't) put on climate change will in all likelihood be exceeded.

Though it may be possible to adapt, often imperfectly, to some of the effects of climate change, Mr Victor argues that it is much harder to help others adapt. Countries with the sort of institutions that allow them to divert resources to adaptation will do so anyway; those without won't, even if showered with support from others. He finds that research into geo-engineering, which might slow or check the temperature increases, languishes under-examined, and that the international problems such technology would raise seem no more likely to be sorted out wisely than the problems of climate change itself. Meanwhile the scope for bad policy at a national level-such as useless but hard-to-reverse subsidies for "solutions" like corn ethanol-grows ever larger.

At the heart of Mr Victor's analysis is the fact that governments can and do enact policies aimed at reducing emissions, but they cannot reliably predict how much reduction such policies-always a mixed bag of regulation, markets and subsidies, tailored to local requirements, vested interests and political possibilities-will bring about. Yet quantitative promises about cuts in emissions have become the be-all and end-all of international negotiations. Because such hard numbers cannot be guaranteed, countries don't commit ambitiously to this sort of agreement: result, gridlock. Much better, Mr Victor argues, to promise each other specific policies, including those with indirect benefits such as some forms of energy research and development, rather than specific outcomes that can be weighed by the tonne of carbon.

Much better, too, to do so in a small group where offers can be compared and ambitions bid up, rather than trying to engage the whole world at once. This is not just an a priori assertion; the "policies and measures" approach got nowhere when floated at UN negotiations in the 1990s.

Mr Victor's idea of "climate clubs", in which countries keen on action band together and entice the less willing with offers of preferential technology and investment deals, looks as if it might yet have something to offer. In some ways it reflects the way that international negotiations have been heading, though their new "bottom up" direction was reached more by default than by strategy. There is an irony, though, in the fact that the best example he has of such club-like progress is the development of the World Trade Organisation; the moribund impasse of the WTO's current Doha round, and the fact that a climate club, in ensuring benefits for its members, might well find itself up against WTO rules on discriminatory trade, make it a double-edged source of inspiration.

Mr Victor has delivered one of the most thought-provoking analyses of policy responses to climate change for some time. If it is not optimistic, that is not his fault.

Index | Books & Arts

New poetry

Mr Difficult

Hard work-but worth it

Clavics. By Geoffrey Hill. *Enitharmon Press; 41 pages; pound12.* Buy from Amazon.co.uk

GEOFFREY HILL, who became the Oxford Professor of Poetry after Ruth Padel was forced suddenly to resign in 2009, is generally acknowledged to be difficult. His poetry-rich in allusions, unattributed quotations and revelling in the obscurity of words-requires multiple dictionaries to hand, leading it to being far more studied than read.

Born in Worcestershire in 1932, the son of a police constable, Mr Hill is considered by many to be one of Britain's greatest living poets. But aspects of his work do not lend themselves to popular appeal. The tendency of his poems to focus on the anxiety of an agnostic faith has made him an easy target for parody. His poetry, like his celebrated criticism, demands a certain austerity and intensity; for the reader to be seemingly as disciplined and as educated as the poet.

On first reading, Mr Hill's new collection, "Clavics", does little to dispel this difficult image. "Poetry is eccentric," Mr Hill claims in it, a "Labour of Pride". The poet takes as his initial subject matter a little known Cavalier composer, William Lawes, who at his death in the battle of Chester in 1645 was already overshadowed by his brother, Henry. Over 32 poems Mr Hill traces an elegiac sequence for Lawes and his music, intermingling the historical events around his death with flashes of the everyday. The result is a collection that delights in eccentric incongruities. Ben Jonson will appear a line after a popular instant coffee blend has been mentioned, Dante will be found next to a mime artist, Marcel Marceau, and Lawes himself figures auditioning for Ronnie Scott. Mr Hill actively seeks out such juxtapositions. He will audaciously rhyme "haruspex", an Etruscan soothsayer who saw prophecies in the entrails of victims, with "bad sex", his poetry delighting in "a dissonance to make them wince".

And such wincing dissonance is perhaps appropriate for a poet who, alongside writing about religious angst in a secular age ("I have admired/Dawkins' mortal quips/As was required"), also writes deftly about the public role of the poet, and the anxieties attached to such a position. Harmony and lyricism are hard to find in a world which can seem so disjointed, and Mr Hill's growling "lyric-loutish" voice ensures a reader never forgets this. And yet, when we are told to "Splash blessings on dead in Afghanistan" the sudden mention of contemporary conflicts may seem overly ironic or crude.

Yet, as Mr Hill writes, when speaking of Lawes's tendency to jar different musical themes, "the grace of music is its dissonance." This discordance is part of his wider belief in the public nature of poetry. Refusing to be a "light entertainer" like the hypocrites in Dante's inferno, Mr Hill presents a difficult world as he sees it. His gift lies in making such difficulty momentarily understood.

Index | Books & Arts

New fiction

He's got bottle

The muck at the bottom

In the Rooms. By Tom Shone. *Thomas Dunne Books; 352 pages; $24.99. Hutchinson; pound14.99.* Buy from Amazon.com, Amazon.co.uk



What happens when a non-alcoholic starts going to AA meetings? A splash of cynicism, a dash of self-doubt and a good measure of humour, according to Tom Shone's new novel, "In the Rooms". Patrick Miller, an English literary agent floundering in New York, needs a big break. During a lunchtime stroll he spies Douglas Kelsey, a once-celebrated author admired by Patrick at college, who has seen better days. With the hope of securing a blockbuster book deal he follows him into a meeting for recovering alcoholics. Patrick is soon immersed in the parallel world of the sober, with its unwritten rules, coded language and quirky characters.

Mr Shone has a sharp eye for contemporary Manhattan, perhaps because he emigrated there from Britain himself. His skilful turn of phrase instantly draws the scene. You feel safe in his literary hands as Patrick wanders blindly down paths unknown, colliding with troubled people on the mend-gruff Douglas, friendly but crazy Felix and the intoxicating but damaged Lola.

Mr Shone injects plenty of satirical laughs. Alcoholism is a sensitive subject, and he treads carefully the ironic line between tragedy and comedy. In one awkward but entertaining scene at a colleague's party, a sober Patrick is caught protesting his sobriety to his dry friends who urge him not to hurt himself as he clutches a bottle of champagne. Then a sozzled client drags him away jeering that he always steals the booze.

But behind the comedy he also muses on larger themes without being preachy: the American Dream, and how foreigners get sucked in by New York's neon lights and either enjoy the ride or get spat out; self-discovery, a key aim for recovering alcoholics but also a universal goal; and man's relationship with booze.

Is Patrick an alcoholic in denial, or is he a non-alcoholic with an identity problem? There are some moments of navel-gazing from the almost puritanical reformed characters, and some passages verge on the absurd, but Mr Shone maintains a pace that whips the story back to reality. "In the Rooms" is an entertaining page-turner about humanity, with plenty of hilarity.

Index | Books & Arts

Susan Sontag

Desperately seeking Susan

A clear-eyed portrait of a complicated and fascinating woman

Sempre Susan: A Memoir of Susan Sontag. By Sigrid Nunez. *Atlas & Co; 144 pages; $20.* Buy from Amazon.com

"GET me Susan on the phone", Robert Silvers told his assistant at the *New York Review of Books*. "Susan who?" was a stupid response. Chuckles rippled through the office. In the late 1970s there was only one: Susan Sontag.

It was "*sempre* Susan", writes Sigrid Nunez, that former assistant, in an affecting memoir of the same name. When Ms Nunez first met Sontag in 1976, the author was already that rare specimen in America: a public intellectual. She had made her name with a collection of bracingly erudite essays, "Against Interpretation", published a decade earlier when she was 33. A regular sight at New York parties, she stood out for being a handsome woman of cerebral insouciance, with two novels and another book of essays under her belt. But her first bout with cancer left her in need of an assistant, and 25-year-old Ms Nunez fitted the bill. An aspiring novelist, Ms Nunez was glad for a job that was "unlikely to interfere with my writing". In hindsight, this is a joke; Sontag's influence would be profound, particularly when Ms Nunez hooked up with her son, David Rieff, and they all lived together as an unwieldy threesome on the Upper West Side in the late 1970s.

In those early days, Sontag offered a relentless education. She was a passionate and intimidating mentor, introducing Ms Nunez to Walter Benjamin and Jean-Luc Godard, to sushi and Studio 54. In her book-lined, sparsely furnished flat, nights came with smoke-filled conversations about art. A woman of outsized appetites, Sontag was always torn between the "heroic vocation" of writing and a night on the town. She loved going to the cinema, aimed to read a book a day, hated to waste time sleeping and could make a meal of a packet of bacon. She was sexually omnivorous, but she believed in love-"and when she fell she fell *hard*".

Always dressed in trousers and flats, she felt disdain for timid women. Weakness in others brought out Sontag's cruelty. "Stop letting people bully you," she bullied Ms Nunez. A feminist, she "found most women wanting", preferring the company of men. Sontag could work with inspiring bravado, pounding away at her typewriter in long, Dexedrine-fuelled binges. Once a sickly child from an unintellectual family, she saw her life as a triumph and felt contempt for anyone who "didn't do what they truly wanted to do".

But she was needy and narcissistic, anxious for the approval of others and incapable of being alone. "My first feeling about everything I write is that it's shit," she confessed to Ms Nunez. With time Sontag grew "mortally malcontented", often seething with outrage and regret. She wanted to be better known for her fiction, but it took her years to write a novel worth reading-"The Volcano Lover" in 1992. She adored her son and kept him close, but couldn't bear to be his mother, preferring to be "Susan", his "goofy big sister". She rarely let him be alone with Ms Nunez. Coming home late at night, she would sometimes knock at their door: "May I come in?" (The relationship would have ended anyway, Ms Nunez avers, but Sontag expedited its implosion.) When the time came, Sontag was not ready to die. She ultimately abandoned the logic she set out in "Illness as a Metaphor" (1978), which prescribed a cool acceptance of medical fact. She had so much more to write, to read and do that she could not bear to let go. She was still too alive.

Ms Nunez, now a fine novelist, has written a clear-eyed tribute to a woman who remains fascinating years after her death from leukaemia in 2004. With an eye for the telling detail, this intimate and occasionally raw portrait makes it plain that despite all Sontag's public renown, much of her was entirely mysterious.

Index | Books & Arts

African voodoo

The dark arts

A new exhibition raises questions about the perception of Africa



Pins not included

A DUCK'S bill, rodent legs, a crustacean pincer, rusting scrap metal, strings of small coloured beads, bird feathers, threads of plant seeds, a tiny terracotta pot, dangling cowrie shells, all bound tightly together on a plump female effigy carved in wood. This maternity figure is just one fetish among nearly 100 exhibits from Benin and Togo currently showing at the Fondation Cartier in Paris, the first time that the private collection of voodoo statuary belonging to the late Jacques Kerchache, a French explorer and collector, has gone on display. The result is as fascinating as it is repulsive.

Most objects are violent, raw, macabre, and deliberately so. A fetish is a sacred object that embodies the spirit or power of a god. Many are composites, assembled under instructions from a diviner, coated in palm oil and blood and then activated to invoke the power to protect, or harm. Most components carry specific symbolism: a duck's bill silences speech; an eagle's claw gives strength; slave irons mean pain or death. Incantations are uttered into holes in the statuettes, and wooden pegs (or, more recently, metal padlocks) inserted to seal the spell; the location of the pegs indicates where the body is to be harmed. Vodun is the name scholars give to the African religious cult originating on the Slave Coast, which was exported under the name voodoo to the plantations of Haiti, Cuba, Brazil and elsewhere in the Americas, and is still practised today.

In this glass-and-steel exhibition space there is nothing of a musty museum of ethnological curiosities. Most figures are elegantly displayed in glass cubes in a low-lit room, the idea being to dignify them. Oddly, though, there is no explanatory labelling. "Kerchache wanted people to be confronted with the power of the objects," explains Leanne Sacramone, the exhibition's curator, "not just to look at labels." But can the aesthetics really be separated from the objects' ritual meaning? Kerchache himself once wrote that "In Africa, function is inseparable from beauty." With a major exhibition of Dogon sculpture also opening this week at the Musee du Quai Branly, Paris is becoming a showpiece for traditional African art. The tough question is how far this dignifies tribal tradition, or simply further exoticises Africa.

"Vodun: African Voodoo" is at the Fondation Cartier in Paris until September 25th

---

Index | Books & Arts

Correction: Malcolm X

We were wrong to imply in our review of Manning Marable's book that the face of Malcolm X appeared on an Iranian stamp but never on an American one ("What he might have become", April 9th). In 1999 Malcolm X was the 22nd in the US Postal Service's "Black Heritage" series. Our apologies.

Index | Obituary

Juliano Mer-Khamis

Juliano Mer-Khamis, Jew, Arab, actor and activist, died on April 4th, aged 52



THE two young men in the suicide-video were bearded, nervous and pale. They stood in their camouflage fatigues and bandannas in front of the flag of the al-Aqsa Martyrs' Brigades. One, carrying a rifle, would not look towards the camera. The other read out a message to friends and family, bidding them a terse goodbye: "Heaven is precious, and *jihad* is the way."

Some years before, Juliano Mer-Khamis had worked with these boys in his mother's theatre in Jenin, in the Palestinian West Bank. Their names were Nidal (with the rifle) and Yousef. Nidal, with his cheeky smile, had crawled around on all fours pretending to be a cat, miaowing daringly round the legs of the girls. Stouter Yousef had preened himself in crimson silk, playing a king. Now he was on his way to kill four Israelis and wound 40 more.

Many might conclude that his brush with theatre had done no good at all. Mr Mer-Khamis drew the opposite conclusion. The horror of Yousef and his murders convinced him that the teeming, dilapidated refugee camp in Jenin needed more stagecraft, not less. He didn't believe that acting would heal the trauma of Israeli invasion, destruction and occupation; as one of "his" boys said later, "He doesn't feel sorry for us." Acting to him was never just a distraction, art for art's sake. It was a means of strengthening Palestinian resistance by freeing the self and gaining confidence. Rather than throwing stones or learning to shoot, his young actors could curse, dance, shout poems, sing. With his deep, passionate voice and wildly waving arms, he would teach the children of Jenin to hurl words and music at the occupiers until they overcame

them, and the armoured cars trundled back across the Green Line. "Aren't we here for something?" he would cry to the faint-hearted.

His Freedom Theatre, set up in 2006 to replace his mother's workshop (bulldozed by the Israelis four years earlier), was the first acting school in occupied Palestine. It drew audiences from Ramallah, Bethlehem and even Israel, bused in semi-secretly through the mountains. By 2009 700-800 children attended every year, including many girls. There was a waiting list. They acted "Alice in Wonderland" and a Palestinian version of "Animal Farm" in which the children, in their pig masks, learned to speak Hebrew and dared to suggest that fighters in their own *intifada* might become like their oppressors. In the battered cement labyrinths of the camp, where the only entertainment came from TV or mobile phones, the theatre was Mr Mer-Khamis's seeding ground for a brand new and liberated Palestinian identity.

His own identity was another question. His ideal, flung out with his usual unstoppable bravado, was to be nothing, selfless, unlabelled, just a free human being. Yet, if anything, he wore too many labels. He was a Jew, the child of a mother, Arna ("the sun in our house"), who had fought as a pioneer for the state of Israel before becoming a feisty, raucous advocate of Palestinian rights. He was an Arab whose father, an Arab Christian, had led the Communist Party in Nazareth. He could be a good Israeli, doing his army service as a paratrooper and acting the hero in gung-ho films such as "Kippur" or "Rage and Glory". And he was Palestinian, in the sense that when he strolled through the Jenin streets, familiarly cuffing and glad-handing the children who swarmed round him, he was one of them.

Two tribes

Yet he never was one of them exactly. Though Jewish extremists saw him as an Arab, in Jenin he was "Uncle Jule", the good Jew, frustratingly pigeonholed as a philanthropist. At worst, some of the boys who acted for him thought he might be a spy for the occupation. He co-founded his theatre with Zacharia Zubeidi, once the military head of the al-Aqsa Brigades, whom he had inspired to turn away from violence. It didn't help. Suspicious parents saw him as an Israeli agent, an unwelcome proselytiser for Western values who let their daughters act with boys and even take the leading roles.

He had a secular Israeli's loose informality; but he always found Israel hard to deal with. As a soldier in 1978 he was ordered to drag an elderly Palestinian from his car; he refused and was sent to prison, realising then that "the outfit could not fit". His film about his mother's theatre, "Arna's Children" (2004), which included the story of Nidal and Yousef and their transformation into terrorists, was not exactly banned in Israel, but it was neither distributed nor discussed. He felt he was an "alien being" before an Israeli audience, and considered Israeli society "pathological". Though he lived in Haifa, he found himself spending longer periods in Jenin.

By this spring, however, Muslim hostility to his projects was becoming harder to bear. The theatre had twice been firebombed; in 2009 flyers had been sent to him, warning of bullets if he stayed. In one interview he said he had never felt so Jewish as he did now in Jenin, suddenly needing every scrap of his field training, thinking like a beleaguered soldier. When he was killed outside his theatre, shot five times by a man who apparently had links to Hamas, some marvelled that he had not tried to leave the camp sooner. But he was from the elite Sayeret unit, he had explained once. They never ran away.
